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NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

THESIS

**THE IMPACT OF RESOURCE WEALTH ON ECONOMIC
GROWTH, GOVERNANCE, AND CONFLICT IN
AFGHANISTAN**

by

Mark C. David

September 2013

Thesis Advisor:
Second Reader:

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**THE IMPACT OF RESOURCE WEALTH ON ECONOMIC GROWTH,
GOVERNANCE, AND CONFLICT IN AFGHANISTAN**

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Submitted in partial fulfillment of the
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ABSTRACT

Immense natural resource wealth lies buried within Afghan soil. The potential revenue stream resulting from the extraction of minerals and hydrocarbons from the country has been identified as a replacement for international aid and ultimately as a catalyst for self-sustaining economic growth. Political instability and the potential adverse effects of resource abundance in underdeveloped countries, however, pose challenges to this assertion.

Afghanistan's long history of aid dependence is used as a proxy measure in this study to assess the impact of large revenue streams on political and economic institutions. While research found that foreign aid had a detrimental effect on institutional quality within Afghanistan, the study also determined that a critical difference exists between the method in which aid was dispersed, and the manner in which large-scale resource revenue payouts will necessarily occur within the country.

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LIST OF ACRONYMS AND ABBREVIATIONS

AGS	Afghan Geologic Survey
CPI	Corruption Perception Index
DRC	The Democratic Republic of Congo
ERP	Economic Recovery Program
EITI	Extractive Industries Transparency Initiative
GDP	gross domestic product
IDLG	Independent Directorate of Governance Control
ISAF	International Security Assistance Force
MoM	Ministry of Mines
MCC	Metallurgical Corporation of China
NPP	National Priority Program
NRRC	National and Regional Resource Corridor Program
NSP	National Solidarity Program
SAIL	Steel Authority of India Limited
SIGAR	Special Inspector General for Afghan Reconstruction
SOE	State-owned enterprise
SSD	skills strategy development
TCC	Tethyan Copper Company
TFBSO	Taskforce for Business and Stability Operations
USAID	United States Agency for International Development
USGS	United States Geologic Survey
WGI	World Wide Governance Indicator

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I. THE IMPACT OF RESOURCE WEALTH ON ECONOMIC GROWTH, GOVERNANCE, AND CONFLICT IN AFGHANISTAN

Located at the collision point of the Eurasian and Indian continental plates, Afghanistan sits on some of the most diverse and difficult terrain in the world. The Hindu Kush range in the country's northeast juts 20,000 feet into the troposphere, while the southwest portion of the country comprises an arid plateau that barely averages 3,000 feet above sea level. It is what lies beneath the twisted terrain, however, that is attracting billions of dollars in investment capital from Central and East Asian powers. Afghanistan's natural-resource wealth is as diverse as its landscape—untapped deposits of copper, iron ore, gold, zinc, uranium, oil and natural gas all abound—in massive quantities. Pentagon estimates place the value at more than U.S. \$1 trillion.¹

A. CENTRAL RESEARCH QUESTION

How is natural-resource wealth shaping government and economic institutions within Afghanistan? What effects do these institutional changes indicate for Afghanistan's economic growth, level of conflict, and stability?

B. IMPORTANCE

Afghanistan's future is at a precarious crossroad. Natural resources have the potential to bring stability and prosperity to the nation, resulting in ancillary geostrategic benefits to the region and beyond. Continued instability in the region, however, will keep Afghanistan isolated from global markets, limit its economic growth potential, and perpetuate the prevailing cycle of poor governance. A keen understanding of the relationship between resource extraction and its effect on government institutions is an essential forerunner to any successful future strategy. Natural resource dependence will also have effects on Afghanistan's domestic political stability, as described in the literature review below.

¹ James Risen, "U.S. Identifies Vast Mineral Riches in Afghanistan," *The New York Times*, June 13, 2010, <http://www.nytimes.com/2010/06/14/world/asia/14minerals.html?pagewanted=all>

Afghanistan's central location on the Asian continent has placed its resource wealth directly in the crosshairs of the rapidly expanding Chinese and Indian economies. Past Chinese business practices in Afghanistan and Africa have shown that they are willing to lower their ethical standards to that of their host nation, with the rural population of those countries often disproportionately affected by the environmental destruction and harsh labor conditions that result from poor oversight and accountability. As Afghanistan's mineral extraction industry is in its initial stages of development, it is essential to determine the trajectory upon which the current stewards of these resources have placed the country.

From a national security perspective, the United States has once before paid the price for ignoring the Afghan people when it was falsely assumed U.S. interests had been met in the region following the Soviet defeat in 1989. A decade of Soviet hostilities destroyed both formal government and traditional dispute mechanisms, creating an unstable power vacuum left for the Afghans to sort out. What resulted was truly a lose-lose arrangement—while Afghans were subject to draconian rule under the Taliban, extremist non-state actors with maximalist goals found sanctuary in a region filled with disaffected citizens now neglected by the Western world. Going forward, a significant portion of the U.S.'s national security rests on a stable and productive Afghan society that can secure its borders, insulate its population, and deliver the good governance and economic outcomes to sustain the population's livelihoods and well-being.

C. PROBLEMS AND HYPOTHESES

The central problem Afghanistan's mineral wealth poses is suggested by dense amounts of literature indicating a "resource curse," where countries with high ratios of primary exports to gross domestic product (GDP) tend to have slower economic growth and higher levels of corruption and conflict.² While the U.S. draws down its security presence in the country, the game is already on to exploit the nation's buried wealth. Both

² Jeffrey D. Sachs and Andrew M. Warner, "Natural Resource Abundance and Economic Growth," NBER Working Paper no. 5398. *National Bureau of Economic Research*, December 1995; Michael L. Ross, "What Do We Really Know about Natural Resources and Civil War?" *Journal of Peace Research* 41, no. 3 (May 2004): 337–356. doi: 10.1177/0022343304043773.

China and India have signed multi-billion dollar contracts for extraction rights to Afghanistan's preeminent copper and iron ore sites, respectively. In January of 2013, the Chinese National Petroleum Company began pumping crude from its 25-year tender in the oil-rich northwest of the country.

Although the small and medium-scale extraction is well underway, many ancillary questions remain. It is still unclear how Afghanistan's emerging mineral sector will affect its economic growth, level of conflict, and political stability. How were these contracts negotiated? What were the bidding criteria? How and why were these countries and their state-run enterprises selected to establish the foundation of large-scale extraction in Afghanistan? How are political and economic actors shaping Afghanistan's resource extraction strategy? Most importantly, have the interests of the Afghan citizens been considered in the drive to exploit the country's natural resources? Investigating these questions will portend the future benefit resources will have on economic growth and stability in Afghanistan.

The nature of the problems researched in this thesis requires a significant reliance on perceptions-based governance indicators to formulate a measure of state effectiveness. This form of analysis comes with inherent drawbacks due to ill-defined limitations and imprecise margins for error associated with qualitative type inquiries. Key indexes such as the Corruption Perception Index (CPI) and the World Bank's World Wide Governance Indicator (WGI) draw from large pools of opinion throughout a range of issues affecting a given society. The opinions and perceptions are then used to create a single score from the aggregate data. Specific problems affecting the accuracy of this method of scoring and ranking individual countries arises from: 1) potential hidden biases amongst respondents; 2) the data are often not publicly available and therefore does not lend itself to transparency, leading to; 3) lack of ability by a third party to replicate the results, and; 4) the subjective nature of the data are not backed up by any concrete theory of what comprises "good" and "bad" governance.³

³ Charles P. Oman and Christiane Arndt, "Measuring Governance." *OECD Development Centre Policy Brief* 39 (October 27, 2010), 11. doi: 10.1787/20771681.

Despite the limitations and drawbacks of qualitative governance indicators, these metrics provide valuable information concerning society's approval of leadership at the local, regional, and national level. In the natural resource extraction industry, where the social license to operate relies heavily on local acceptance, these indicators can provide a strong measure of the potential success of particular projects from region to region. While perfect governance indicators do not exist, the broad level of aggregate data and sophisticated measurement techniques used by leading indexes provides the best insight into governance quality currently available.

The hypotheses laid out below are intended to examine whether natural resources are likely to have a positive impact on Afghan government institutions, such as in the case of Botswana, or negative, as in the case of The Democratic Republic of Congo.

1. Hypothesis 1

Extraction of Afghanistan's natural resources continues but poor-quality central governance remains in place. Poor economic and government institutions become mutually reinforcing, leading to a continuation of corruption, exclusive economic opportunity, and elitist rule. The Afghan economy grows resource dependent, and the economy stagnates. In this scenario GDP growth will fail to reduce the country's poverty level.

2. Hypothesis 2

Existing mineral sites become a source for territorial dispute and insurgent financing. Civil unrest in Afghanistan intensifies post 2014 security force pull out. Foreign investment is curtailed due to instability and the natural resource sector remains largely undeveloped.

3. Hypothesis 3

Realization of the potential for significant natural resource revenues drives government accountability and transparency initiatives in order to attract foreign investment to Afghanistan's mineral sector. Resource extraction becomes Afghanistan's economic leading sector resulting in resource corridors, spinoff-business creation, and

sustained long-term growth and stability. This scenario will be characterized by sustained GDP growth, poverty reduction, and the evolution of a complex division of labor.

D. METHODS AND SOURCES

The investigation method to address the proposed research question takes a systematic case-study approach using available data from The World Bank, Transparency International, Bertelsmann-Stiftung, Revenue Watch, and other agencies to examine two key bastions of stability: 1) governance and institutional quality, and 2) public service and finance mechanisms as they relate to Afghanistan. The analysis will focus on the current resource extractive policies set forth by the Afghan Ministry of Mines (MoM). The MoM's role in tendering mineral deposits and structuring contracts is crucial in realizing Afghanistan's full resource potential. As such, scrutinizing their current policies through the lens of industry best practices will determine if the ministry's initial management ethos positively affects economic and governmental mechanisms downstream.

To get a sense of how the MoM's current policies play into the larger scheme of future stability in Afghanistan, the investigation will take a broad look at leading theories on natural resources and economic development, governance and failed state dynamics, and resource-driven conflict. An overall view of the interplay between natural resource revenues and state institutions that have transpired elsewhere will provide an understanding of the dynamics Afghanistan faces, and help craft likely outcomes for the country going forward.

This study will consider indicators of state performance, economic growth, and quality of life. The relationship between GDP and poverty rates is one particularly important measure. A growing economy with no appreciable reduction in poverty indicates a failure of the state-citizen compact. Levels of violence will signal the state's ability to address grievances and provide basic services.

Large-scale resource extraction is in its infancy in Afghanistan and as such rent capture, taxation, and investment policies of the nation remain largely untested. Similarly, the government of Afghanistan's ability to absorb and distribute natural

resource revenue remains unproven pending future investment and growth in the extractives industry. Being a heavily aid-dependent state, however, an analysis of economic aid streams into the country over the past decade can provide a fair approximation of how Afghan government institutions have historically managed income flows. Lessons learned from the influx of donor money, implementation of aid driven projects, and transparency practices can point to areas needing improvement prior to additional large-scale mining operations coming on line.

The ultimate goal of the case study being an understanding how resource rents will shape Afghanistan's economic and political institutions, a detailed survey of the country's historical context is essential. As Naazneen Barma et al. point out in "Rents to Riches? The Political Economy of Resource Led Development," the causal arrow runs both ways between the economic sector and state institutions. Resource rents shape the economic policies set forth by political elites, and these policies in turn determine a country's propensity for resource dependence.⁴ This back and forth sets countries on continuously evolving trajectories, which can be either beneficial or detrimental to economic health. This being the case, it becomes clear that sound governance is crucial to a successful extractive industry. Analysis of current and past leaders and the forms of rule successful in Afghanistan then, plays a key role determining the impact of Kabul's reaction to the mining sector.

E. THESIS OVERVIEW

Chapter I introduces the central research question and the impact of the investigation as it relates to United States interests. The research methodology and topics of inquiry are set forth as well as the general format of the thesis.

Chapter II presents a literature review of theories relevant to the study—specifically, competing theories of economic development and natural resource abundance, governance, failed state dynamics, and Afghan culture and history. The section will briefly present findings from past case study analysis undertaken in

⁴ Naazneen H. Barma, Kai Kaiser, Tuan Minh Le, Lorena Viñuela, "Rents to Riches? The Political Economy of Natural Resource-Led Development," (Washington, DC: World Bank, 2012), 10.

Botswana, Ghana, Nigeria, The Democratic Republic of Congo (DRC), and other resource-dependent and resource abundant countries to identify the relationships between resources and economic growth and political stability.

Chapter III provides a historical background and context of the Afghan State. The section seeks to paint a picture of the social and political environment in which the emerging extractives industry must operate. What are the effects of Afghanistan's ethnic fault lines on designing and approving mining legislation? Are traditional tribal networks vestiges of the past or underlying drivers for policy makers?

Chapter IV goes through a quantitative evaluation of the Afghan society's reaction to the past 12 years of foreign occupation and how various aid driven development programs have affected progress toward stability. Results from this study of the effects of aid trends will serve as an analogy to the potential effects of resource rents on stability, conflict, and government corruption at the local and state level.

Chapter V delves into the state of the current Afghan extractives industry—specifically, the resources at play, the infrastructure in place, and obstacles to extraction. Additionally, this line of inquiry will center on the MoM's mission and vision, bidding process and contract structuring, transparency initiatives, and relationship with the World Bank. What is the basis for policies set forth and what constraints does the ministry operate under? How will these dynamics affect future contract negotiations and foreign investment? The chapter will assess the MoM's performance to date, with a particular focus on how the different commercial, government, and Afghan civil society and political actors interact over natural resource extraction and revenue distribution.

Chapter VI concludes with the findings thus far of Afghanistan's core economic and government institutions. Key points from each of the chapters, when linked, aim to show how the Afghan government will react to natural resource extractive sector and what effect this will have on stability and economic growth. The thesis will end with a few brief policy implications.

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II. LITERATURE REVIEW

The literature considered for this case analysis is broken down into four fields: impacts of natural resources on economic growth, stability, and conflict; governance and failed state dynamics; institutions and institutional change; and Afghan culture and history.

A. NATURAL RESOURCE EFFECTS

The initial academic research on the effects of natural resources centered on their seemingly negative impact to economic growth, a dynamic referred to as the “resource curse.” The seminal finding on the negative association between resource abundance and slow economic growth was advanced in work by Jeffrey D. Sachs and Andrew M. Warner, where evidence showed slow growth rates between 1971–1989 for countries possessing high ratios of primary exports compared with GDP.⁵

Sachs and Warner explain their counterintuitive findings as likely resulting from a dynamic version of “Dutch disease,” where high levels of natural resources drives a higher demand for non-tradable goods, such as services.⁶ Due to inflated wages, the manufacturing sector suffers as labor and capital flee the industry, creating a further reliance on natural resource exports. Sachs puts forward several hypotheses explaining the link between Dutch Disease and slow economic growth. First is a simple explanation from the 14th century suggesting that easy riches lead to apathy, the logic being that inherent wealth is detrimental to ingenuity and work ethic. Second is the idea that abundant natural resources lead to a “feeding frenzy,” where competing factions squabble over resource revenue to the detriment of society. Last, is the economic argument that a robust manufacturing sector, not resource exports, leads to a more complex division of labor in the long term, which in turn leads to a higher standard of living for the society as a whole.⁷

⁵ Sachs and Warner, “Natural Resource,” 2.

⁶ Ibid., 21.

⁷ Sachs and Warner, “Natural Resource,” 5.

Later scholarship on the resource curse has pointed to potential flaws in the Sachs-Warner study stemming from the fundamental distinction between resource abundance versus resource dependence. Previous studies pointing to an inverse relationship between resources and slow growth focused on high ratios of resource exports versus innate natural resource abundance. When resource dependent countries—those with high ratios of primary exports to GDP—were examined, the negative relationship held. However, under the World Bank’s criteria for natural resource wealth, where the measurement is based off per capita mineral deposits, there was actually a positive relationship between resource abundance and economic growth among countries studied from 1970 to 2000.⁸

More recent literature covering the resource curse focuses on the quality of state institutions within resource dependent countries as the variable for determining economic growth. Researcher Christa N. Brunnschweiler conducted a study using the rule of law and government effectiveness as indicators of institutional quality.⁹ Analysis of data for 102 selected countries shows a positive association between quality of institutions and economic growth. The study confirms earlier results from Daron Acemoglu et al. in 2000, indicating that good institutional quality positively affects per capita income levels.¹⁰

While Brunnschweiler found no confirmation that resource wealth negatively affects institutional quality, other works suggest a link. Terry Lynn Karl argues in her work, *The Paradox of Plenty: Oil Booms and Petro-States*, that a reciprocal and continuous relationship exists between state institutions and the economic sector, which over time shapes the evolution of both organizations toward either productive or stunted outcomes.¹¹ Barma et al. found resource-dependent countries score lower in institutional quality when compared with non-dependent countries of comparable GDP. Increases in

⁸ Christa N. Brunnschweiler, “Cursing the Blessings? Natural Resource Abundance, Institutions, and Economic Growth,” *World Development* 36, no. 3 (March 2008), 400.

⁹ Ibid., 404.

¹⁰ Daron Acemoglu, Simon Johnson, and James A. Robinson, “The Colonial Origins of Comparative Development: An Empirical Investigation,” NBER Working Paper no. 7771, June 2000, *National Bureau of Economic Research*, 23.

¹¹ Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States*, (Berkeley, CA: University of California Press, 1997), 6.

GDP resulting from resource revenue were found to not have a corresponding value added in terms of institutional quality.¹² The piece additionally contends that, “How a state extracts, collects, utilizes, and distributes revenues defines its nature,” backing Karl’s assertion.¹³

In *Beyond the Resource Curse*, Barma et al., define two ways in which natural resources interact with governance and state institutions: first, extraction of resources may erode quality of governance by creating political competition over control of resource revenues and; second, resource abundance, regardless of weakening governance, will shape the institutions and economic policies charged with managing the extraction process.¹⁴ Further, the chapter identifies leading hypotheses describing conditions when a resource curse is more likely to take hold: 1) when natural resources constitute the “only game in town”; 2) the distribution of resource rents aligns with existing political-economic cleavages; 3) political power is concentrated in the executive, and; 4) policy commitment is made more difficult by price volatility or political instability.¹⁵

The conditions listed above are particularly relevant to this case study as it can be argued that Afghanistan currently exhibits all four elements to varying degrees, ostensibly making the country acutely susceptible to the resource curse. A number of scholars including Barma have argued, however, that through careful management resource rich nations can escape impediments associated with mineral wealth. Barma’s study, for example, points out that considering a state’s resource management tactics against a standard best practices framework can objectively determine the quality of government and institutional arrangements within the mineral extraction sector.¹⁶ Considering the logic that high quality institutions produce positive economic growth, an

¹² “Rents to Riches? The Political Economy of Natural Resource-Led Development,” 44.

¹³ Ibid., 41.

¹⁴ Naazneen H. Barma, “Petroleum, Governance, and Fragility: The Micro-Politics of Petroleum in Postconflict States,” *Beyond the Resource Curse*, ed. Brenda Shaffer and Taleh Ziyadov (Philadelphia: University of Pennsylvania Press, 2012), 333.

¹⁵ Ibid., 332.

¹⁶ Macartan Humphreys, Jeffrey D. Sachs, and Joseph E. Stiglitz, eds, *Escaping the Resource Curse*. (New York: Columbia University Press, 2007).

objective measure of governance and state institutions is vital. Barma's particular report uses the "resource value chain," devised by the World Bank, as its model framework for judging the extraction process.¹⁷ Consisting of four distinct steps along the path from minerals in the ground to the public investment of mineral rents—Contract awards, regulation of operations, rent collection, and revenue distribution—the value chain framework, when grounded contextually, serves as the basis for identifying a series of institutional and good governance practices within resource extractive countries.¹⁸

B. INSTITUTIONS AND INSTITUTIONAL CHANGE

While opinions vary on the impact of resource curse causality—whether slow growth stems from abundance or dependence, and how this dependence affects growth, stability, etc.—as argued above, this study advances the idea that good quality governance can prevent the resource curse from taking hold regardless of any particular causal mechanism. This being the case, societal institutions that underpin government and economic policy become a central variable in determining successful mineral extraction policies and ultimately economic viability. It is therefore important in this course of research to understand the interplay between institutions, governance, political stability, and economic growth.

Economist Douglas North describes institutions as a series of societal developed constraints, which shape interpersonal relations. In essence they are the "rules of the game in society."¹⁹ North breaks institutions into two categories consisting of formal and informal types. Formal institutions are those rules expressly created by policymakers such as laws and regulations that seek to guide and confine human behavior. Informal institutions on the other hand, are those constraints arising from tradition such as cultural norms and customs.

¹⁷ Barma, "Petroleum, Governance," 334. Adapted from Eleodoro Mayorga Alba, "Extractive Industries Value Chain: A Comprehensive Integrated Approach to Developing Extractive Industries," Africa Region Working Paper Series no. 125, *Oil, Gas, and Mining Policy Division, The World Bank*, (Washington, DC: World Bank, 2009).

¹⁸ Barma et al., "Rents to Riches?"

¹⁹ Douglass C. North, *Institutions, Institutional Change and Economic Performance*, (Cambridge, MA: Cambridge University Press, 1990), 3.

The utility of both formal and informal institutions lie in their ability to provide structure and ultimately reduce uncertainty in everyday life. This measure of stability in everyday life plays a large role in determining whether institutions evolve in a manner that produces efficient or inefficient interactions within society, while a society's ability to adapt is largely determined by the flexibility of existing institutions and society's attachment to past cultural norms.²⁰ A society that can more easily adapt its rules of the game, North argues, is better positioned to take advantage of the opportunities provided through the adoption of more efficient means of transaction.²¹

North cites the example of the United States in the 19th century to illustrate the effect of institutions on the evolution of society. By incentivizing hard work and enacting appropriate alternative consequences, productive organizations prevailed and institutions in the U.S. evolved toward efficiency. Conversely, it is pointed out that many third world countries such as Nigeria and the DRC suffer from an application of reverse incentives placed on the majority of society, causing these countries to veer instead toward exclusive and inefficient means of governance.²²

While North believes that institutional change occurs incrementally, and results when entrepreneurs in the political and economic sector are persuaded that change will deliver personal benefit, scholarship by Ashraf Ghani and Clare Lockhart presents a different take. The pair holds that through national development programs such as Afghanistan's National Solidarity Program (NSP), institutional change can occur relatively rapidly.²³ Ghani and Lockhart demonstrate that good national programs can position local stakeholders around formal institutional rule at the grassroots level. In the case of the NSP, the program established a mechanism that rewarded local leaders and citizens alike with development funds when they adhered to a formal framework of

²⁰ North, *Institutions, Institutional*, 9; Douglass C. North, "The Role of Institutions in Economic Development," UNECE Discussion Paper Series 2003.2, *United Nations Economic Commission for Europe*, October 2003, 2–7.

²¹ North, *Institutions, Institutional*, 9.

²² Ibid.

²³ Ashraf Ghani and Clare Lockhart, *Fixing Failed States: A Framework for Rebuilding a Fractured World*, (Oxford, United Kingdom: Oxford University Press, 2009), 205.

regulations. Establishing this link with a series of carrot and stick measures empowered communities toward adopting more efficient means of local governance and social organization.

Although Afghanistan drafted a new constitution in 2004, informal change in the nation has remained largely static as evidenced by the extent to which tribal customs and norms prevail throughout the country. Due to their imbedded nature, North asserts that informal institutions are more resilient to change within society than formal, a posit which certainly holds in the Afghan example—30 years of political upheaval have made traditional tribal norms the prime means for many Afghans to make order out of a chaotic society. The stubborn nature of Afghan social and cultural institutions seems to present an obstacle to the evolution of efficient mechanisms for economic growth and opportunity. Given Afghanistan's culture of systemic corruption and patronage, the preceding literature suggests that a significant level of institutional change is necessary before policies can be enacted and measures taken to avoid the resource curse.

C. GOVERNANCE AND FAILED STATE DYNAMICS

Contemporary literature on failed states largely focuses on government institutions and the nature of their functions. The literature reviewed acknowledges that institutions lie at the root of state failure, yet frame fundamentals of governance and solutions for failed states in different terms. In *Fixing Failed States*, Ghani and Lockhart contend that a primary function of the state is to connect its citizens to the global stock of wealth and knowledge. The measure of state viability lies in its citizen's level of satisfaction in the performance of core government functions such as security, dispute resolution, and basic health care services that facilitate one's ability to partake in the global market. The key to fixing failed states lies in the idea of "coproduction," a term Ghani and Lockhart use to describe their view that state building involves both internal and external state actors.²⁴ The resulting framework is a "double compact," between the state and its citizens on one hand, and the state and the international community on the other, the latter providing assistance and oversight.

²⁴ Ghani and Lockhart, *Fixing Failed States*, 8.

Daron Acemoglu and James Robinson also assert the idea that a state's institutional makeup determines success or failure. Their recent book, *Why Nations Fail*, describes how governments can be broken into two camps, those with “inclusive” institutions and those with “extractive” institutions.²⁵ Extractive nations are geared toward serving the elite—industries are controlled by a few, and property rights are not honored. These states fail because their citizens are not given the incentive to save, invest, and innovate. Further, economic and political institutions depend on each other for survival; an extractive government cannot exist in a state with an inclusive economy and vice versa. These mutually reinforcing relationships lead societies into either vicious or virtuous cycles of development. The conclusion is that extractive governments are more likely to suffer the adverse effects of natural resource abundance.

The Institute for State Effectiveness agrees with the concept of coproduction forwarded by Ghani and Lockhart stating in its governance manual, “A double compact of rights and responsibilities between citizen and state on the one hand, and between the state and its international partners on the other, can be therefore be helpful” (in creating prosperity and stability).²⁶ The manual also points out however, that elites within corrupt systems often eschew institutional change because of the threat it poses to their personal wealth and monopoly of power. Following this line of reasoning then, it becomes apparent that the government in Kabul, bestowed with immense resource wealth, may pose a significant obstacle to the creation of inclusive institutions and state-society compacts needed to fix Afghanistan.

D. AFGHAN CULTURE AND HISTORY

Understanding Afghanistan's cultural context is essential to successfully analyze the country's response to significant changes in economic and political institutions that the discovery of resource abundance brings. There are numerous sources providing historical and cultural context on Afghanistan. For the purposes of this review, however,

²⁵ Daron Acemoglu and James A. Robinson, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty* (New York: Crown Business, 2012), 73.

²⁶ The Institute for State Effectiveness, “ISE Manuals & Toolkit Series, ISE Governance Manual,” (n.d.), <http://www.eeffectivestates.org/resources.htm>, 52.

those addressing the traditional roots of conflict and civil unrest are the focus. Empirical evidence points to relative peace and stability in Afghanistan as coinciding with periods of strong decentralized rule. Anthropologist and Afghan expert Thomas Barfield characterizes the Musahiban period between 1929–1978, the most peaceful time in the last century, as a time when leaders proclaimed their rule in theory, but realized enforcing such a notion was both undesirable and impractical.²⁷ Conversely, eras where wholesale change was attempted—King Ananullah in the early 20th century, the Peoples Democratic Party of Afghanistan 1978–89, and most recently the Taliban—have resulted in civil unrest and conflict.

While Barfield and others focus on ideological dimensions of civil strife, e.g., Marxists versus Islamists, social scientist David B. Edwards presents a theory that explains Afghan conflict occurring on a more fundamental level. In his words, “Afghanistan’s troubles derive less from divisions between groups or from the ambitious strivings of particular individuals than they do from the moral incoherence of Afghanistan itself.”²⁸ Edward’s central thesis rests on the idea that traditional tribal values in Afghan society, such as revenge and honor based actions, are in many respects incompatible with Islam and universal rule. The resulting contradiction is a conflicted society often in a state of unrest.

Afghan society remains ethnically and tribally fractured. While the effect of this fractionalize on the present state of resource wealth in Afghanistan is yet determined, literature analyzing the effect in other countries from Paul Collier and Anke Hoeffler ostensibly points to a likely increase in civil conflict in the presence of natural resource abundance. These scholars cite low opportunity cost for rebellion and poor government

²⁷ Thomas Barfield, *Afghanistan: A Cultural and Political History* (New Jersey: Princeton University Press, 2010), 337–351.

²⁸ David B. Edwards, *Heroes of the Age: Moral Fault Lines on the Afghan Frontier*, (Berkeley, CA: University of California Press, 1996), 3.

institutions as two of the more prominent explanations for the positive association between natural resources and conflict.²⁹

The low opportunity cost explanation derives from the economic argument that resource dependence leads to low economic growth and higher poverty rates. Impoverished citizens and separatist elements within society in turn have little to lose and much to gain by engaging in civil strife. Conversely, economic opportunity raises the cost of participating in conflict resulting in a more stable society. The poor governance theory derives from several potential resource linkages including “greed” and “grievance” explanations.³⁰ The greed model asserts that insurgents are motivated by personal gain. Territorial disputes flare as a result of the struggle to control resource rich areas. The grievance theory holds that rebellion against the state is more likely in societies where social exclusion and oppression prevail.

One of the difficulties in establishing causal links between natural resource abundance and conflict results from the fact that the mechanisms described above are not mutually independent of one another and can exist simultaneously within a given society. For instance, a resource dependent country that also suffers from poor governance would logically support both a low opportunity cost for rebellion, and a high grievance factor, creating an unclear causal link. In addition, low opportunity cost and political grievance can exist independent of resource abundance, further obscuring a clear link.

Research from Brunnschweiler and Bulte furthers the debate between resources and conflict by accounting for ethnic, linguistic, and religious differences within a resource rich country. The study’s conclusion differs from that of Collier and Hoeffler and other scholars who draw links between resource wealth and conflict. Brunnschweiler and Bulte found that the direct effect of resource wealth tends to actually attenuate the

²⁹ Paul Collier and Anke Hoeffler, “Democracy and Resource Rents,” Working Papers, GPRG-WPS-016, 2005, *University of Oxford, Department of Economics*; Christa N. Brunnschweiler and Edwin H. Bulte, “Fractionalization and the Fight over Natural Resources: Ethnicity, Language, Religion, and the Onset of Civil War,” OxCarre Research Paper no. 2009-17, *Oxford Centre for the Analysis of Resource Rich Economies*, March 2009, 2.

³⁰ Andrew Beath, Fontini Christia, Ruben Enikolopov, “Winning Hearts and Minds through Development? Evidence from a Field Experiment in Afghanistan,” Policy Research Working Paper 6129, *The World Bank*, July 2012, 5.

risk of war—although the causal mechanism still remains unclear—and the net effect of resources on conflict is ambiguous.³¹ In situations with increased ethnic divisions however, the pair found a corresponding increase in the chance for conflict when natural resources were present. The same did not hold true for religious or linguistic fractionalization. The positive correlation held only for above soil resources however, leading to the possibility that other factors such as land scarcity and tenuous property rights may be the driver for the increase in conflict, supporting a theory proposed by Catherine Andre and Jean-Philippe Platteau in 1998.³²

While much has been written on the systemic corruption and patronage networks within Afghanistan, and the MoM has taken strides to promote transparency, Professor Jonathan Goodhand presents counterview to the prevailing idea that corruption is inherently detrimental to state building. In his study, Goodhand examined the opium trade in Afghanistan and determined that collaborative relations between government officials and elite power holders in rural areas resulted in regions of relative stability, increased monetization, and marketization.³³ In a state with weak central governance, peace building is likely to prevail when power and resource bargains are struck between rulers and elites in the periphery. Though corruption may produce inefficiencies, Goodhand points out that the dividends of peace may outweigh any costs of graft. Applied to the emerging natural resource sector, investors and donors may have to accept that priming the patronage pump may initially be a necessary evil to ensure political stability.

³¹ Brunnschweiler and Bulte, “Fractionalization,” 1.

³² Catherine Andre and Jean-Philippe Platteau, “Land Relations Under Unbearable Stress: Rwanda Caught in a Malthusian Trap,” *Journal of Economic Behavior and Organization* 34, no. 1, (1998): 1-47, <http://search.proquest.com/docview/56786441?accountid=12702>.

³³ Jonathon Goodhand, “Corrupting or Consolidating Peace? The Drugs Economy and Post-conflict Peacebuilding in Afghanistan,” *International Peacekeeping* 15, no. 3 (May 21, 2008), 406, doi: 10.1080/13533310802058984.

III. THE EFFECTS OF CULTURE AND RELIGION ON POLITICAL AND ECONOMIC INSTITUTIONS

A. INTRODUCTION

This chapter provides a brief overview of the ethnic, cultural, religious, and political dynamics within Afghan society. The importance of this discourse lies in the concept that culture often stands in the way of institutional reforms, and institutions matter for economic growth. While the goal is to describe the contemporary state of affairs in the country, historical context is provided to explain the origins of cultural norms and customs currently affecting societal and economic institutions today. The opening of the natural resource industry affects the full range of Afghan society, from the leaders in Kabul who handle contracting and resource rents, to rural villagers who may live in the vicinity of a larger scale mining operation, or who may partake in smaller scale extraction. The potential for wide spectrum of operations, from mega-resource tenders to smaller wildcat outfits, makes the cultural and political backdrop of Afghanistan a key element in analyzing the working relationships between leaders, citizens, and outside entities.

In particular this chapter focuses on the distinct rural-urban split in Afghan society. Much of Afghanistan's population resides at the village level where tribal customs and norms maintain order and trump institutionalized rule, yet the viability of these tribal codes are often overlooked by outsiders accustomed to more conventional forms of governance. Rule in Afghanistan occurs on many levels. The political landscape of the country can be viewed as a series of concentric rings of authority beginning with the village and radiating out to the district, provincial, and finally the national level.³⁴

The disjointed nature of the relationship between central rulers in Kabul and citizens in the periphery has fostered a culture of autonomy amongst rural Afghans. Weak central governments have traditionally relied on local powerbrokers to stem the gap and maintain stability in regions beyond the administration's capacity to govern. These

³⁴ M. Jamil Hanifi, quoted in Thomas H. Johnson and M. Chris Mason, "No Sign until the Burst of Fire: Understanding the Pakistan-Afghanistan Frontier," *International Security* 32, no. 4, Spring 2008, 51.

arrangements trade the benefits of stability for the drawbacks associated with corruption and patronage. The maintenance of client networks however, weakens economic potential within Afghanistan as national resources are siphoned off to buy the support of local elites.

B. ETHNIC AND SOCIAL STRUCTURE

The body of Afghanistan's societal makeup is comprised of four distinct ethnic groups. Primarily inhabiting the central and southern portions of the country, Pashtuns have been the most dominant group since 1747 when they were brought together under Ahmed Shah Durrani in a confederacy that would later form the modern day nation of Afghanistan. Pashtuns currently represent 42% of the total population. Despite representing less than half of the population, the Pashtun plurality dominates Afghan culture. Leaders of the country have all been ethnic Pashtun, and the group's tribal code of conduct constitutes a parallel form of governance that is the prevailing law of the land outside of urban centers. Traditionally the terms Pashtun and Afghan were interchangeable but have since diffused into separate descriptive spheres as inhabitants have flowed into the region. Tajiks, predominantly occupying the northern reaches of Afghanistan, are the second most populous group comprising 27% of the population. Hazaras and Uzbeks, prevailing from central and northwestern Afghanistan, respectively, each represent 9% of the total population.³⁵

The CIA World Fact Book estimates Afghanistan's population at just over 31 million as of 2013. While Kabul has seen a rapid rise in population with the onset of the Taliban insurgency, some 80% of Afghans still reside in small villages where subsistence farming and pastoralism allows a largely autonomous existence independent of urban city centers.³⁶ This dichotomy of Afghan society, which leans heavily toward the rural and semi-autonomous, fosters a society where traditional norms and customs remain deeply engrained and local governance reigns supreme throughout the countryside. Accordingly,

³⁵ Central Intelligence Agency (CIA), "The World Factbook – Afghanistan," August 22, 2013, <https://www.cia.gov/library/publications/the-world-factbook/geos/af.html>; Barfield, *Afghanistan*, 19.

³⁶ Barfield, *Afghanistan*, 32.

the rural portions of Afghanistan have been described by many experts as an interwoven web of ethnic, tribal, and local characteristics which, depending on region and particular situation, take on varying roles in the makeup of one's identity.³⁷

C. INFORMAL INSTITUTIONS OF GOVERNANCE AND TRADE

A common falsehood attributed to the exterior regions of Afghanistan is the notion that they are ungoverned spaces.³⁸ The fact that many of these spaces lie outside the reach of the central government's administrative capacity reinforces the impression of lawlessness to many outsiders. The reality is quite opposite however, as the tribal lands have been autonomously governed for a millennia by traditional codes of conduct, chiefly Pashtunwali (the way of the Pashtun). This honor-based tribal code, which incorporates such basic tenets as hospitality, justice, retribution, forgiveness, and independence, serves as an all-encompassing institution guiding both formal and informal interactions within Pashtun society.³⁹ Abiding by the code is compulsory—doing so certifies one's honor. Pashtunwali code has endured numerous central government collapses and has proved instrumental in maintaining clan harmony in the face of state failure.⁴⁰ During times of war, the integrity of the cohesive tribal system has historically gained strength on every level thereby serving as the sole mechanism by which many Afghans retain social order in an otherwise chaotic environment.⁴¹

The robustness of tribal codes has bestowed rural villages with the organic means to administer governance and dispute resolution at the local level. The inner workings of tribal dynamics are described by Afghan scholars in terms of a "triangle of power," a trifecta of village leadership positions composed of village elders, mullahs, and

³⁷ Bernt Glatzer, "War and Boundaries in Afghanistan: Significance and Relativity of Local and Social Boundaries," *Weld des Islams* 41, no. 3, (2001), 6; Thomas H. Johnson and Chris M. Mason, "Refighting the Last War: Afghanistan and the Vietnam Template," *Military Review* (November-December 2009), 6.

³⁸ Johnson and Mason, "Refighting," 9.

³⁹ Palwasha Kakar, "Tribal Law of Pashtunwali and Women's Legislative Authority," *Islamic Legal Studies Program, Harvard Law School*, 2005, 2.

⁴⁰ Johnson and Mason, "No Sign," 59.

⁴¹ Glatzer, "War," 12.

government officials.⁴² When in equilibrium, village elders represent the most dominant leg of the triangle, mullahs the second but much smaller side, and government officials an even smaller segment. Credible estimates show that some 95% of clan disputes are resolved by this council of trusted village members through the Jirga process—an assembly that relies on consultation and consensus to draw judgment. Tribal Mullahs play a small but important role in the process by ensuring decisions are in accordance with religious principles. Because of the perceived fairness, egalitarian nature, and religious endorsement, judgments arising from Jirgas are widely accepted throughout the village.⁴³

Tribal law, being based on restorative rather than punitive justice however, makes for an inherently precarious peace. Tribal disputes are settled in an eye-for-an-eye manner with the aim of restoring harmony amongst tribesmen and surrounding neighbors.⁴⁴ Despite its utility, tribal justice occasionally results in blood feuds that can last generations. This type of conflict, which turns members of society inward and xenophobic, hinders opportunity for broader trade and development within the state.

Further, in a clan type society such as rural Afghanistan's, reputation and honor bound trade practices, while legal contracts are largely foreign and bare little merit. Business agreements and relationships are forged personally and over long periods of time. Conversely, in the international world of business, non-personnel trade, contracts, and legal documents supplant reputation and honor. While face-to-face business dealings can thrive on the micro level, this rural form of transaction makes it harder for a society to transition to more complex forms of industrialization, which require risks and capital mobilization beyond the capacity of informal institutions of trade.⁴⁵

⁴² Johnson and Mason, "Refighting," 10.

⁴³ Ibid.

⁴⁴ Vern Liebl, "Pashtuns, Tribalism, Leadership, Islam, and Taliban: A Short View," *Small Wars & Insurgencies* 18, no. 3 (2007): 492–510, doi: 10.1080/09592310701674481.

⁴⁵ Pranam Bardhan, *Scarcity, Conflict, and Cooperation: Essays in the Political and Institutional Economics of Development*, (Cambridge: MIT Press, 2005), 9–13.

D. **ROLE OF ISLAM IN AFGHAN SOCIETY**

Afghanistan is a thoroughly Muslim nation on several levels. Centuries of Islamic influence from neighboring Arab dynasties has had a great effect on the religious identity of the country, transforming the nation from a Buddhist and Zoroastrian past to one where nearly the entire population currently distinguishes itself as Muslim.⁴⁶ The Sunni sect of Islam accounts for 85% of the country's Muslim inhabitants while the remaining 15% are Shia and belong mainly to the Hazara and other ethnic groups.⁴⁷ Beyond the sheer plurality of the religion, Afghanistan is described by experts as possessing an older type of Islamic society where the religion transcends mere ideology and becomes an all-encompassing way of life.⁴⁸ In this sense, all interactions—be it business dealings, moral dilemmas, or dispute resolutions—are tempered with Islamic doctrine and jurisprudence.

Few nations can claim a level of homogeneity equal to that exhibited by Afghan Muslims. While the myriads of tribes within the country remain segmented and distinct, Islam has been used as a tool in the past by various actors to rally the population against both foreign intrusions, as was the case in the Anglo-Afghan wars, and against the state itself, as was the case with the progressive measures of King Amanullah.⁴⁹ Indeed, the prevailing national sentiment holds that Afghans are the strongest, most pure believers in Islam, and therefore cede to no one on the grounds of their interpretation of the religion.⁵⁰ Afghans are Muslim by birth—little else is necessary to maintain that status apart from abiding by tribal norms and mores. Forging a life as an honorable Afghan in effect, makes one a good Muslim in the eyes of society. Because of the integral role Islam plays in the day-to-day dealings amongst Afghans, interactions with so-called nonbelievers are generally conducted with suspicion.⁵¹

⁴⁶ Barfield, *Afghanistan*, 17; CIA, "The World."

⁴⁷ Barfield, *Afghanistan*, 32.

⁴⁸ Ibid., 40.

⁴⁹ Ali Banuazizi and Myron Weiner, *The State, Religion, and Ethnic Politics: Afghanistan, Iran, and Pakistan*, (New York: Syracuse University Press, 1988), 9.

⁵⁰ Barfield, *Afghanistan*, 42.

⁵¹ Ibid., 42.

The grafting of Islam with traditional Afghan tribal codes has not been a seamless process. The melding of the two often results in contradictory judgments and moral incoherence.⁵² Tribal codes such as those that prescribe honor-based restitution and revenge-motivated actions are out of step with the widely accepted forms of Islamic teachings and Sharia jurisprudence. A key factor that facilitates the ability for Afghans to layer Islam over deep seeded tribal mores lies simply in the fact that the majority possesses a weak conceptual understanding of the religion and its core tenets.⁵³ For instance, under Taliban rule, commerce, education, and public welfare—all tenets traditionally valued by Muslim societies—were obviated under Taliban rule, despite the group’s self proclaimed image as practitioners of the Islamic faith.⁵⁴ Further, theological debate is not an aspect of the rural style Islam practiced in Afghanistan. This unquestioning nature—or blind loyalty to one’s religion, coupled with a poor understanding of the faith, has created a historical susceptibility to manipulation from perceived religious authorities.

The inculcation of Islam in Afghanistan has occurred lockstep with colonial forays and interventions in the country. The rise of the religion owes much to the fact that it was often used as an opportunistic tool in rousing disparate tribal groups against invading powers. Early examples of the exploitability of Afghan piety date back to the Afghan-Anglo wars in the late 19th century where accounts of charismatic Mullahs used religious narratives to incite uprisings against British soldiers. A clear early example of this occurred in 1897 when a local religious figure from the Swat valley named Mullah Saidullah began to spread foreboding rumors of an impending holy war between Afghans and Colonial powers. Saidullah’s sermons were peppered with tales of fantastical powers, and “heavenly hosts” that would accompany he and his followers into battle with their foreign occupiers.⁵⁵

⁵² Edwards, *Heroes*, 3.

⁵³ Johnson and Edwards, “No Sign,” 58.

⁵⁴ Liebl, “Pashtuns,” 54.

⁵⁵ Edwards, *Heroes*, 184.

Mullah Saidullah's mix of charisma and mysticism found great appeal amongst the tribes of rural Afghanistan. His demagogic antics were essential to his ability to quickly mobilize local villagers in raids against the British garrisons at Chakdara and Malakand.⁵⁶ British soldiers were justly taken aback by the 5,000-strong militia that turned out against their fortifications—noting the swift and fanatic nature of the raid—many were left to question previous assumption that tribesmen lacked the requisite organization to conduct coordinated attacks.⁵⁷ Winston Churchill, a soldier and war reporter in Malakand during the time, ascribed several factors for the successes of the Mullahs in the region. First, the penchant for rural Afghans to take rumors at face value frequently turned gossip and hearsay into accepted truth. Second, villagers tended to latch on to charismatic leaders and their promises, following them despite anecdotal evidence to the contrary.⁵⁸

Contemporary tribal culture in rural Afghanistan still exhibits an inclination for the fantastic machinations and the captivating power of charismatic leaders that Churchill described a century ago. Mullah Saidullah, later branded “Mad Fakir,” became one of many clerics associated with “Mad Mullah” insurrections that continue today.⁵⁹ Mullah Omar, spiritual leader of the Taliban, is a modern example of the enduring pertinence of these two forces amongst Pashtun society. Omar's rise to “Commander of the Faithful,” and former de facto leader of Afghanistan, was surrounded by legendary tales of his prowess as a Mujahedeen soldier and his self-reported visions as Afghanistan's savior. In 1996 Omar solidified his mythical status when he donned a cloak purported to belong to the prophet Mohammad and scaled a hillside for his followers to see.⁶⁰ While short of the outlandish claims and theatrical showmanship of Mullah Saidullah a century ago, Omar's otherworldly persona and fiery rhetoric against outsiders evoked a primal resonance in many disaffected Pashtun villagers.

⁵⁶ Edwards, *Heroes*, 185.

⁵⁷ Ibid., 178.

⁵⁸ Ibid., 180.

⁵⁹ Ibid., 189.

⁶⁰ Mujib Mashal, “The myth of Mullah Omar,” *Al Jazeera*, June 6 2012, <http://www.aljazeera.com/indepth/features/2012/06/20126665650415526.html>.

E. A PRECAUTIONARY TALE FROM PAKISTAN

In principle, Islam is completely compatible with responsible corporate business practices.⁶¹ In reality, the conservative form of Islam practiced amongst Pashtuns, coupled with the long history of foreign intervention in South Asia, has forged negative attitudes toward western business endeavors in the region. Foreign ventures risk many stigmas—from being purveyors of un-Islamic vices, to occupiers of Muslim lands, to neo-colonialists with monopolistic agendas. The tale of the Reko Diq copper-gold project in Pakistan's Baluchistan region provides a vivid example of the negative impacts of xenophobic and ethnically fractured societies on business opportunities.

Reko Diq is an untapped copper and gold deposit located in the remote region of Baluchistan boasting an estimated \$60 billion worth of extractable material. The Tethyan Copper Company (TCC), a joint Canadian-Chilean venture, possessed the exploration rights to the area, and since 2006 the company has expended \$220 million in exploration and feasibility studies. The company planned to invest a total of \$3.3 billion in infrastructure at the site, including a processing facility, a power plant, and an underground pipeline to the Arabian port of Gwadar. The mine was to employ 11,000. In addition to royalties and taxes, the government of Baluchistan had a handsome 25% stake in the operation. All told, Pakistan stood to share half of the operation's estimated \$60 billion yield—for no money down.⁶²

In 2011, the Baluchistan provincial government abruptly denied TCC a license to mine Reko Diq. While TCC did not get an official explanation, Reuters news agency quoted a local government official stating that TCC was “cheating” Baluchistan. “They are a monopoly . . . they don't want to disclose the worth of the gold in Baluchistan.”⁶³ Shortly after TCC was denied its exploitation license, the government of Baluchistan granted 11 exploration permits to 5 inexperienced Pakistani and Chinese mining outfits.

⁶¹ Md. Anowar Zahid and Kamal Halili Hassan, “Corporate Social Responsibility to Employees: Considering Common Law Vis-à-vis Islamic Law Principles,” *Pertanika Journal of Social Sciences and Humanities* 20 (June 2012): 87–100.

⁶² Chris Allbritton, “Fool's Gold? Pakistan mine rift exposes investor risk,” *Reuters*, February 17, 2012.

⁶³ *Ibid.*

Subsequent negotiations between TCC and the Baluchi Government failed, and in 2013 the company pursued monetary damages for prior investments and lost profits through the international court of arbitrations. TCC Chief Executive stated of the situation, “Recent developments have regrettably compelled Tethyan to withdraw the request for specific performance . . . while we have long hoped to mine Reko Dik, as is Tethyan’s right, the conduct of Pakistan and Baluchistan has made that goal impractical.”⁶⁴

Mining in rural portions of Afghanistan is acutely dependent on a social license to operate. Before smooth extraction operations can occur, locals must be fully accepting of a foreign footprint on their land. The strong xenophobic streak amongst many Afghans will pose a challenge in peripheral areas of the country. Ethnic fragmentation and dearth property rights issues will have to be assuaged in order to avoid Reko Diq type follies from occurring in Afghanistan.

F. ENDURING REGIONS

Afghanistan’s history as a buffer state has produced a nation whose present borders are not drawn according to distinct geographical or ethnic lines, but were created as a result of encroaching imperial powers.⁶⁵ The major ethnicities within Afghanistan—Pashtuns, Tajiks, and Uzbeks—are therefore split amongst the neighboring countries of Pakistan, Tajikistan, and Uzbekistan respectively. The shared cultural, social, and ethnic ties amongst Afghanistan and the surrounding Asian States create a natural environment for regional trade networks. Lack of state capacity and harmonized trade agreements however, has suppressed formal trade and resulted illicit exchange networks including the smuggling of natural resources out of Afghanistan.⁶⁶

Afghanistan is best described an amalgamation of the four distinct regional components. These regions, most commonly identified by their historical urban centers—

⁶⁴ Reuters, “Barrik, Antofagasta venture gives up Pakistan project Reko Diq,” May 8, 2013.

⁶⁵ Barnett R. Rubin, *The Search for Peace in Afghanistan: From Buffer State to Failed State* (New Haven, CT: Yale University Press, 1995), 3.

⁶⁶ Masood Aziz, “Afghanistan,” in *The New Silk Roads: Transport and Trade in the Greater Central Asia*, ed. S. Fredrick Star (Washington, DC: Central Asia-Caucasus Institute & Silk Road Studies Program, 2007), 56; Matthew DuPee, “Afghanistan’s Conflict Minerals: The Crime-State-Insurgent Nexus,” February 16, 2012, *Combating Terrorism Center*, <http://www.ctc.usma.edu/posts/afghanistans-conflict-minerals-the-crime-state-insurgent-nexus>.

Kandahar, Kabul, Herat, and Mazar-i-Sharif, have each retained their cultural ubiquity despite political, religious, and other outside influence.⁶⁷ Herat, which lies in the western portion of the country, has long been culturally and politically tied to Iran. Because of its location along the ancient Silk Road, Herat served as a strategic junction point for goods transiting between China and Persia. Herat is best recognized as the cultural capital for arts and literature in Afghanistan and for the historically high production potential of its citizens.⁶⁸ Kandahar in the south lies in the center of the Pashtun belt and was the site of the original capital of Afghanistan prior to its transfer to Kabul in 1776. While the Registan Desert dominates the topography, the region is fed by the Helmand River, which provides irrigated plains for agriculture. The region plays host to the nation's robust poppy production. Mazar-I-Sharif is the site of the nation's most significant shrine, which draws many pilgrims each year. The region's northern disposition places it on top of the massive petroleum fields that dominate Central Asia. Kabul holds the nation's capital and the central eastern position in the country. The region traditionally supports the highest population with some 30% of the nation's citizens residing within the area. Kabul serves as the gateway to the strategic Khyber Pass that links Afghanistan to Pakistan through the Hindu Kush range.

Throughout history these four key regions have operated variously as independent kingdoms, under the rule of assorted empires, or were autonomously governed at the local level and paid homage to a central power.⁶⁹ The enduring individual identity of Afghanistan's regional components produces a state that is better described as an empire vice a nation. This creates a condition where state autonomy is precariously dependent on client-patron relationships. The emergence of mineral wealth complicates these relationships, as Kabul must ensure that it distributes resource rents to local leaders within shared jurisdictions. In short, when neither the state nor local leaders possess the sole extraction authority, a situation arises where predation and rent-seeking occurs on both the local and national levels.

⁶⁷ Barfield, *Afghanistan*, 49.

⁶⁸ Barfield, *Afghanistan*, 49.

⁶⁹ *Ibid.*, 48.

G. POLITICAL LEGITIMACY, DECENTRALIZATION, AND REGIONAL AUTONOMY

Political legitimacy in Afghanistan has historically flowed from dynastic (monarchy or patrilineal) and religious means. The archetypal leader in Afghanistan is one who unquestionably possesses either or both of these virtues.⁷⁰ Effective past leaders such as Ahmad Shah Durrani (1747–1772), Dost Muhammad (1826–39; 45–63), Abdur Rahman (1880–1901), and Mohammad Nadir Shah (1929–33), were those who in addition to holding regal lineage were further perceived as exemplifying military acumen and dominant personas. These traditionally successful rulers earned their stature through their ability to fend off rivals and maintain tribal harmony.⁷¹ In short, beyond heritage, stature in Afghan society remains very much merit based. The same sets of qualities attributed to these former rulers are also commonly possessed by local powerbrokers, or “strongmen,” scattered throughout peripheral regions in Afghanistan.⁷²

Contentious past relationships between the central state and the semi-autonomous marginal regions of Afghanistan have unfortunately led to a widely accepted belief that the country is ungovernable. Counter to conventional wisdom, much of the population in Afghanistan has historically accepted state rule—but not in the modern democratic sense Western countries are accustomed to. The successful leaders mentioned above were keenly aware of both the limits and reach of their authority, and of the Pashtun affinity for independence. These leaders proclaimed their rule in theory, but realized enforcing such a notion was both impractical and undesirable. The majority of the Afghan population for their part have historically accepted state rule as long as it was brokered through local trusted agents and remained ostensibly unobtrusive.⁷³ This bestows local leaders with powerful hedges to state authority and makes their role key for implementing national economic policies.

⁷⁰ Johnson and Mason, “Refighting,” 4.

⁷¹ Barfield, *Afghanistan*, 306.

⁷² *Ibid.*, 308.

⁷³ *Ibid.*, 337.

The symbiotic relationship of semi-autonomy-for-allegiance that has been forged between the peripheral population and the leadership in Kabul has led to a decentralized form of state rule where local governance and regional strongmen play a key role in maintaining harmony and order. A recurring theme in Afghan history is the rejection of wholesale change, especially amongst the rural regions. King Amanullah's social initiatives in the 1920s, the Marxist doctrine of the Peoples Democratic Party of Afghanistan (PDPA), and the extreme form of Islam enforced by the Taliban all resulted in rejection and overthrow. The rule by proxy relationship between the center and the exterior has naturally lent itself to the establishment of a robust patronage network amongst elite local actors and state authorities. The maintenance of such a network negatively effects economic growth as elites become focused on channeling revenues toward further consolidating their power vice funding productive development projects.⁷⁴

H. CENTER-PERIPHERAL RELATIONSHIPS

Contemporary Afghanistan can aptly be categorized as a patrimonial state.⁷⁵ While thirty years of war and political upheaval has seen new actors entering the scene at both the local and state level—a dynamic which has destroyed many of the long established center-periphery relationships—the culture of patronage still runs deep in Afghan society. Prior to formation of the current state-run institutions, client-patron relationships formed the bedrock of the nation's political economy and, despite centralization efforts since, a clear distinction between formal and informal, and state and non-state dimensions of politics and business still does not exist.

Since the early consolidation of the nation's various territories into a state, local power brokers have played an integral part in a complex network of relationships with the central capital. Patronage networks in Afghanistan traditionally are established around various formal and informal arrangements such as appointments, marriage, gift giving,

⁷⁴ Nicolas Van De Walle, *African Economies and the Politics of Permanent Crisis 1979-1999*, (Cambridge, United Kingdom: Cambridge University Press, 2001), 53.

⁷⁵ Andreas Wilde, "The Consistency of Patronage: Networks and Powerbrokers of the 'Arzbegi Clan' in Kunduz," in *Local Politics in Afghanistan: A Century of Intervention in the Social Order*, ed. Conrad Schetter (New York: Columbia University Press, 2013), 73.

favours, or protection. Generally the establishment of these connections was an imperative for rulers. While the degree of power conferred from the center has waxed and waned through successive leaders, cresting with the rule of the Abdur “Iron Emir” Rahman at the turn of the 19th century, Afghanistan has historically been a unitary state under monarch rule. The nature of state administration under the king, at least prior to the PDPA coup in 1978, was aimed at maintaining order, not permeating local politics.⁷⁶ Successful leaders imposed change in the urban areas and allowed their writ to slowly emanate to the periphery. In this respect the state heavily relied on the ability of its local elites and strong men to mete out changes and keep peace in the hinterlands. In exchange for maintaining order, local leaders were given leeway to impress political and economic agendas as they saw fit as long as their actions did not pose a threat to the central state powers.

Since 2001, foreign interventionists in Afghanistan have pushed ideas of state building that aim to marginalize or eliminate the country’s customary client-patron network. Indeed, viewed through a western lens, the stature and dealings of local elites, warlords, and powerbrokers are seen in a distasteful light by many. Those in developed nations accurately categorize these relationships and practices as constituting any number of forms of corruption, crony capitalism, or nepotism. Further, decentralized patron-client forms of administration, it is held, tends to portray a maligned view of the central government in the eyes of the rural citizens since the state’s capacity to deliver services is seldom apparent. This dynamic is seen in the fact that some 78% of rural Afghan villagers trust their local leaders, but rulers in Kabul are largely viewed with contempt.⁷⁷

Despite the inefficiencies of corruption and the poor relationships forged between rural citizens and state leaders as a result of rule by proxy, stable periods in modern Afghan history have taken place coincidentally with the existence of healthy center-periphery relationships. Conversely, those times following regime change, such as the periods after the overthrow of King Amanullah in 1929, and the coup that unseated King

⁷⁶ Wilde, “The Consistency,” 178.

⁷⁷ Jennifer Brick, “The Political Economy of Customary Village Organizations in Rural Afghanistan,” Department of Political Science, University of Wisconsin, 2008, 1.

Zahir Shah in 1973, have been accompanied by phases of civil unrest associated with the severing of ties between central rulers and regional strongmen. The Afghan civil war spanning 1992–1996 is a bitter example of the type of power vacuum that is created post regime upheaval in Kabul. Absent a central figurehead with strong ties to the periphery, civil unrest descended upon the nation as the influence of regional warlords remained unchecked.

The cornerstone of the most recent state building expedition, the Bonn Agreement of 2001, sought to establish an interim administration until such time “a fully representative government can be elected through free and fair elections.”⁷⁸ With the agreement, the drafters both effectively eliminated the role of a monarch in Afghan politics and imposed a deadline for elections despite the fact that the country had never conducted such a process. The provisions of Bonn served to damage the legitimacy of the current president, Hamid Karzai, in several ways. First, the presidential elections robbed the leader of the traditional Afghan path to ascendancy. The fact that they were surrounded by accusations of corruption only made matters worse. Second, the time-honored Afghan maxim that leaders must be free of foreign influence (even if they are receiving aid) has been lost on the current leader.

Despite the aims of Bonn the importance of strong center-periphery relationships persist. Afghanistan’s Independent Directorate of Governance Control (IDLG) is a presidential body that seeks to reestablish central control at the subnational level by appointing officials at the provincial and district levels who have ties to Kabul. The program is not without its drawbacks and detractors, while the agents selected may have close ties to Kabul, they are often outsiders to the community they are appointed to oversee. Further, community-building programs such as the National Solidarity Program (NSP), which seeks to empower villages through bottom up-development projects and local good governance, run counter to the imposition of top-down governance.⁷⁹ The existence of these two competing programs speaks to the current unsettled state of the rural-urban split within Afghanistan.

⁷⁸ Afghanistan Government, “Bonn Agreement,” 2001, <http://www.afghangovernment.com/AfghanAgreementBonn.htm>.

⁷⁹ Wilde, “The Consistency,” 7.

I. CONCLUSION

Afghanistan remains an ethnically, geographically, and politically fractured nation. The absence of broad colonization or strong central rule in the country's history has produced a state where distinct regions dominate, and governance has evolved through decentralized channels. Regional powerbrokers are vital entities in reconciling the multitudes of diverse tribes and villages with the central authority in Kabul. The challenge for the Ministry of Mines is the crafting of an industry of extraction that passes the social license to operate within the far reaches of Afghan society yet retains the level of transparency required by international actors. Foreign investors on the other hand should realize that, at least in the near term, the dividends of social and political stability might outweigh the inefficiencies associated with a well-primed patronage network.

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IV. EFFECTS OF AID DEPENDENCE AND RESOURCE REVENUE ON GOVERNMENT INSTITUTIONS

“The natural resource sector has the ability to make up 40% of Afghanistan’s GDP.”

—Whadullah Sharrani, Afghan Minister of Mines, 2012

A. INTRODUCTION

By the close of the military mission in 2014, the United States will have spent \$100 billion in an effort to reconstruct Afghanistan.⁸⁰ This chapter examines the effect that these reconstruction funds have had on government institutions and economic progress in Afghanistan in an attempt to better understand the potential impact of resource revenue from the country’s emerging mining industry. Foreign aid and resource revenue bear characteristics to similar “windfall gains” where recipient countries are essentially dealt a free stream of income.⁸¹ These alternate sources of state revenue have varying, but analogous, effects on political and economic institutions, thus examining the past effects of one can serve as a close approximation of the future effects of another.

The manner and magnitude in which aid and resource revenues are dispensed and collected within a country produce different effects on host nation governance and economic growth. For instance aid programs that are pinpointed in their aim and conditionally implemented tend to have a more positive effect than those without oversight or strings attached.⁸² Similarly, resource revenue derived from subsoil, labor-intensive operations, seems to cause less conflict within society than operations associated with lucrative, easily extracted minerals—so-called “lootable” resources, which tend to prolong existing conflicts.⁸³ The degree to which governments are able to handle the economic shocks associated with ambitious aid programs and resource booms plays a

⁸⁰ Special Inspector General for Afghanistan Reconstruction (SIGAR), *January 30, 2013 Quarterly Report to the United States Congress* (Arlington, VA: Author, 2013), <http://www.sigar.mil/pdf/quarterlyreports/2013-01-30qr.pdf>.

⁸¹ Carl-Johan Dalgaard and Ola Olsson, “Windfall Gains, Political Economy, and Economic Development,” Working Paper in Economics no. 223, September 5, 2006, 1.

⁸² Institute for State Effectiveness, “Programs and Activities,” last modified 2008, <http://www.effectivestates.org/programs.htm>.

⁸³ Ross, “What Do We?”

large role in determining whether rents are cycled toward productive means or captured by rent-seeking individuals and siphoned out of the local economy. The following analysis attempts to account for the numerous variables associated with windfall gains by using existing literature and cross-national regression analysis of other rent dependent nations in an effort to draw parallels and conclusions from Afghanistan's current political and economic standing.

B. CHARACTERISTICS OF FOREIGN AID

There are dense amounts of literature describing the effects of aid on government institutions, level of corruption, and the economic growth of recipient countries. On the most general level, two schools of thought exist concerning the utility of aid programs in developing countries—simply that aid either has a positive or negative affect on corruption, quality of governance, and long-term economic growth. Closer examination of studies from the field reveals that there are numerous variables that need to be accounted for when evaluating a particular country's situation. What was the level of corruption before the influx of aid? Were conditional measures placed on the aid and aid programs? What was the preexisting level of political stability? What is the level of human capital? How much aid is devoted to investment? What was the magnitude of the aid package—carefully metered or a massive windfall? What is clear from the literature is that every aid dependent country has its own unique set of factors and variables to the extent that, while generalizations can be made as to the overall effectiveness of aid, each case must be evaluated on its own merit in order to draw the most accurate conclusion as to the effectiveness of aid within a particular nation.

While there is no consensus on the long-term benefit of aid, recent studies have introduced and highlighted particular dynamics that are associated with the application of aid. Celebrated work by Craig Burnside and David Dollar in 2000 found that aid only stimulated economic growth in countries possessing sound macroeconomic policies.⁸⁴ Paolo Mauro's analysis of corruption and growth confirmed that corruption hinders

⁸⁴ Craig Burnside and David Dollar, "Aid, Policies, and Growth," *The American Economic Review* 90, no. 4 (2000), 847-868, <http://search.proquest.com/docview/57027368?accountid=12702>.

economic progress, while Alberto Alesina and Beatrice Weder made the interesting discovery that countries with higher levels of corruption actually garner higher amounts of aid, thus creating an ambiguous causal link between corruption and aid.⁸⁵ Carl-Johan Dalgaard and Ola Olsson established an association between levels of economic aid and growth, where moderate aid inflows show a positive effect, while larger sums are less effective and even detrimental to economic growth.⁸⁶ Henrik Hansen and Finn Tarp further this logic by suggesting a “diminishing marginal returns” hypothesis where there exists a break point in the amount of aid a particular society can manage.⁸⁷ When the amount of aid exceeds a given level, rent-seeking behavior will predominate over productive endeavors and entrepreneurship. Finally, Kevin Murphy, et al. show in their work “Why is Rent-Seeking so Costly to Growth,” that in countries where individuals are oriented toward rent-seeking, slower economic growth follows.⁸⁸

\Afghanistan’s reaction to aid presents a complex case study as the country is strongly affected by endogenous factors such as inhospitable geography, cultural habits, and political instability as well as exogenous factors in the form of intense foreign machinations and strategic interests. Fortunately Afghanistan’s long record of aid dependence dating back to the initial British influence in 1830s provides ample opportunity by which to study the effects of aid over various periods in the nation’s history. Since the so called “Great Game,” the competition of expanding empires between Czarist Russia from the North down, and British India from the south up, Afghanistan’s geostrategic position has resulted in a nation that has been subject to external aid since early in its statehood. This pattern of external influence was repeated during the Soviet

⁸⁵ Paolo Mauro, “Corruption and Growth,” *Quarterly Journal of Economics* 110, no. 3 (1995), 681-712, <http://www.jstor.org/stable/2946696>; Alberto Alesina and Beatrice Weder, “Do Corrupt Governments Receive Less Foreign Aid?,” *The American Economic Review* 92, no. 4 (2002), 1126-1137, <http://www.jstor.org/stable/3083301>

⁸⁶ Dalgaard and Olsson, “Windfall Gains,” 15.

⁸⁷ Henrik Hansen and Finn Tarp, “Aid Effectiveness Disputed,” *Journal of International Development* 12, no. 3 (2000), 375-398, <http://search.proquest.com/docview/56075298?accountid=12702>

⁸⁸ Kevin Murphy, Andrei Shleifer, Robert Vishny, “Why is Rent-Seeking so Costly to Growth?” *The American Economic Review* 83, no. 2 (1993), 409, <http://search.proquest.com/docview/233027400?accountid=12702>

occupation from 1979–89, and most recently with the U.S. and coalition effort beginning in 2001 to present.

C. CURRENT STATE OF AFFAIRS IN AFGHANISTAN

Afghanistan remains an aid dependent country today. Since 2001 the United States alone has apportioned \$89 billion in reconstruction aid.⁸⁹ Total military and foreign aid for 2011–2012 dispersed to Afghanistan amounted to \$15.7 billion—a figure equalling to the nation’s GDP.⁹⁰ The following section argues that this massive sum was simply beyond the absorptive capacity of Afghanistan’s fledgling economy and has therefore led to profuse rent-seeking behavior amongst elites and powerbrokers within society. This in turn has perpetuated corruption throughout the state, which has stymied economic growth and fostered instability as the majority of the population is subject to elitist rule and exclusive economic opportunity. The dynamic of emergent patterns of corruption and the associated adverse economic effects are covered more thoroughly in Chapter V.

The Special Inspector General for Afghanistan Reconstruction (SIGAR) produces a detailed report to the United States Congress every quarter documenting inefficiencies and misappropriation of aid funds. While the aim of the Special Inspector General is to curb corruption and strengthen the conditionality placed on aid, the sheer scale of the discrepancies found—U.S. \$4.5 billion worth of abuses in the January 2013 report alone—seems to suggest that the magnitude of aid overwhelms the country’s ability to resist corruption and rent-seeking behavior despite international oversight.⁹¹ Further, much of the aid has been focused on top-down programs and initiatives ill aimed at spurring productivity and stemming corruption. One particularly poignant example found in the SIGAR report details the audit of two Afghan National Boarder Police facilities located in Kunduz and Nangarhar provinces. The facilities were constructed at a cost of U.S. \$27 million, but upon follow up inspection it was found that the facilities were either

⁸⁹ SIGAR, *January 30, 2013*.

⁹⁰ Nekia Lane, “Economics of Self-Sustainability: The Future of Afghanistan’s Economy,” *Civil-Military Fusion Center*, August 2013, 1.

⁹¹ Lane, “Economics,” 23.

empty or used for unintended purposes, including one that functioned as a large chicken coop.⁹²

Governance and economic indicators remain low in Afghanistan. The Bertelsmann-Stiftung Transformative Index, which evaluates the quality of democracy, market economy, and political management, ranks Afghanistan 124th out of 128 transforming countries.⁹³ In Transparency International's Corruption Perceptions Index, a surrogate measure of governance quality, Afghanistan shares the bottom of the list with North Korea and Somalia for highest degree of corruption.⁹⁴ Since 2005 Afghanistan has shown a negative trend on the corruption index despite an increasing trend in aid for governance and development (increasing from \$195 million in FY 2002 to \$4.5 billion for FY 2010).⁹⁵

Using data introduced above, several inferences can be made concerning the association between corruption and aid in Afghanistan. First, the volume of aid has exceeded the "diminishing marginal returns" point and is driving rent-seeking behavior and corruption amongst elites. Second, the rising levels of corruption are negatively impacting economic growth. A further empirical observation that can be derived from the past decade of foreign aid lies in the dynamic that, while per capita gross domestic product (GDP) has risen steadily, from \$198 in 2003 to \$619 in 2011, much of this growth is attributed to revenue associated with the foreign military mission.⁹⁶ The services industry, which captures much of the foreign expenditures, accounts for Afghanistan's largest portion of GDP at 54%. While the value added as percent of GDP has steadily risen in the services sector, the corresponding measure in the industrial sector has fallen from its highpoint in 2006, and exports as a percent of GDP have steadily

⁹² Ibid., 14.

⁹³ Bertelsmann-Stiftung, "Transformation Index BTI 2012," (n.d.), <http://www.bti-project.org/index/status-index/>.

⁹⁴ Transparency International, "Corruption Perception Index 2012," (n.d.), <http://cpi.transparency.org/cpi2012/results/>.

⁹⁵ Special Inspector Report for Afghanistan Reconstruction, *April 30, 2013 Quarterly Report to the United States Congress* (Arlington, VA: Author, 2013), 202–203, <http://www.sigar.mil/pdf/quarterlyreports/2013-04-30qr.pdf>.

⁹⁶ Bertelsmann-Stiftung, "Transformation Index."

declined over the same period.⁹⁷ This data indicates that the Afghan economy has grown dependent on foreign expenditures and that the draw-down of the military mission in 2014 will have a significant negative impact on the services sector (and therefore per capita GDP of the country as a whole) as the “temporary resource boom” established by the sizeable military footprint wanes.

Following Burnside and Dollar’s postulate that aid only stimulates growth in countries possessing sound macroeconomic policies (e.g., low inflation and balanced budgets), Afghanistan’s 10% inflation rate in 2012, rising corruption, and falling export sector suggests fiscal policies are inadequate and misguided. Further evidence of poor fiscal policy lies in the fact that despite the impressive increase in per capita GDP since 2003, the country’s poverty level has been stuck at 36% since 2008.⁹⁸ This data taken as a whole suggests that leaders will need to make significant adjustments to fiscal and monetary policies before the natural resources sector can positively affect economic growth and development.

D. UPSIDE POTENTIAL OF NATURAL RESOURCE REVENUE

While the historical effects of aid have shown useful in identifying shortfalls in Afghanistan’s economic policy (and can serve as a proximate measure to forecast the potential affect natural resource revenue will exert on government institutions and economic growth) there remain important distinctions between aid and resource revenue that merit explanation. A particularly critical difference is that resource revenues, unlike aid, have a tangible basis—the resources themselves. Resource rich states enjoy a comparative advantage in a particular sector and thus the potential for industrialization and development based on organic means.

World Bank analysts Gary McMahon and Brandon Tracy identify three avenues for development that natural resources bring: industrialization, infrastructure, and fiscal

⁹⁷ The World Bank, “Afghanistan - Exports of goods and services (% of GDP),” (n.d.), <http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS/countries/AF-8S-XM?display=graph>.

⁹⁸ The World Bank, “Afghanistan: From Transition to Transformation II,” July 2, 2013, <http://www.worldbank.org/content/dam/Worldbank/document/SAR/afghanistan/SOM-WorldBank-July2013.pdf>.

revenues.⁹⁹ Industrialization potential includes both the extractive sector itself and businesses that provide support and services to the sector such as mining supply companies and transportation services. Infrastructure development includes transportation advances such as highway and rail systems, power generation and distribution grids, and other tertiary developments such as piped water and telecommunications networks. Fiscal revenues result from the mines themselves in the form of royalty payments, taxes, and tendering fees, in addition to taxes derived from support industries. While aid can certainly finance industries, build infrastructure, and directly increase fiscal revenues, a further upshot that resource-based revenues enjoy over aid are the “spillover effects” associated with developing an economy grounded in a tangible good.

The idea of the spillover effect comes from leveraging an industry, in Afghanistan’s case large-scale extraction operations, to form “resource corridors” comprised of smaller scale support businesses that provide goods and services to the extraction process. The scale of the businesses opportunities induced by large-scale mining operations can be quite broad—ranging from street vendors, to gear suppliers, to maintenance of railway and transportation equipment and beyond.¹⁰⁰ The goal behind a resource corridor is to economically diversify specific areas by rendering local individuals capable of providing inputs to industry. The key to the creation of a resource corridor is to enable the establishment of spinoff businesses that both add value to the economy, by locally processing and transforming raw materials into intermediate and finished products, as well as capturing and reinvesting incomes earned.¹⁰¹

The number of indirect jobs created around an extraction operation often outnumbers the total employment generated directly by the mine itself.¹⁰² Recent studies

⁹⁹ Gary McMahon and Brandon Tracy, “The Afghanistan Mining Sector as Driver for Sustainable Growth: Benefits and Opportunities for Large-Scale Mining,” *Oil, Gas, and Mining (SEGOM)*, *The World Bank* (Washington DC: World Bank, 2011), 7.

¹⁰⁰ McMahon and Tracy, “The Afghanistan,” 15.

¹⁰¹ The World Bank, *Afghan Resource Corridor*, video, 5:44, (n.d.), <http://www.worldbank.org/en/news/video/2012/07/02/afghanistan-resource-corridor-video>

¹⁰² Fraser Institute, “How many jobs depend on the mining industry?” *miningfacts.org*, 2012, <http://www.miningfacts.org/Economy/How-many-jobs-depend-on-the-mining-industry/>

estimate indirect job creation ranging from 2–8 times that of the primary mine.¹⁰³ The buildup of a service and support industry around a primary mining site drives a dynamic form of growth often referred to as the “multiplier effect,” where the injection of revenue leads to additional local spending, which in turn leads to additional income for spinoff and support business in the region, and so on. Analysis of the Argentinian mining sector shows that for the 87,000 directly employed by the mines throughout the country, 316,000 indirect jobs were created, a four-fold effect. The Yanacocha mine in Peru showed a 14-fold effect.¹⁰⁴

E. GOVERNMENT’S ROLE IN AVOIDING THE PITFALLS OF RESOURCE REVENUE

The successful multiplier effect exhibited in Peru’s Yanacocha mine requires careful government planning and sequencing to establish resource corridors and to prepare citizens to capitalize on business opportunities. An array of initiatives are available to host governments that can ignite economic development in resource rich areas—from requiring domestic procurement of equipment, to organic skills formation, to piggybacking off of infrastructure enhancements. The Economic Recovery Program (ERP) initiated by resource rich Ghana is one example of a government-implemented plan to multiply mining revenue and increase domestic value added. In the early 1980s Ghanaian leadership established training programs to fill positions that would otherwise go to expatriates and passed a minerals mining act that, which amongst other protections, required companies to domestically procure 60% of their purchases by year 4 of operation. Under this legislation Ghana saw their mining sector grow, from comprising 1% of GDP in the 1980s to 6% GDP by 2008. Share of mining exports increased from 20% to 45% over the same period, and foreign direct investment in the sector amounted to nearly U.S. \$8 billion from 1994 to 2010.¹⁰⁵

In addition to the multiplier income resource corridors create, other long term benefits of industrial buildup around mineral sectors include the potential for

¹⁰³ McMahon and Tracy, “The Afghanistan,” 35.

¹⁰⁴ Fraser Institute, “How many jobs?”

¹⁰⁵ McMahon and Tracy, “The Afghanistan,” 4.

diversification of manufacturing within the region, a dynamic which has been reasoned by Sachs and Warner to increase the long term overall standard of living for society as a whole. This form of economic diversification that capitalizes on side stream linkages developed by spinoff industries is an important factor in reducing a nation's dependence on primary exports, thus lessening the likelihood of that country suffering from "Dutch Disease," where resource rents crowded out manufacturing.¹⁰⁶

Reforms and intervention programs unfortunately do not happen by accident; rather conscious and committed government efforts are required to enact change. In addition, empirical evidence suggests that leaders must be either incentivized or forced to enact policy reform. Economist Stephan Haggard argued, "International shocks and pressures, and the domestic economic crisis associated with them, have been the most powerful stimuli for changes in policy."¹⁰⁷ Indeed, the Ghanaian ERP reforms came on the heels of a deep financial crisis that resulted in a military coup in 1981. The leader of the coup, Jerry J. Rawlings, stated in an address to the nation, "The time has now come for us to restructure society in a real and meaningful democratic manner so as to ensure the involvement and active participation of the people in the decision making process."¹⁰⁸ This change in leadership and thinking that followed were the catalysts for the Ghanaian government to pursue IMF intervention and structural adjustment, which eventually reversed of the nation's precipitous economic decline.¹⁰⁹

Regardless of Mr. Rawling's motivations, Ghana's ERP program represented a shift away from policies that were geared toward serving an elite few, and toward the type of "inclusive" economic institutions. Acemoglu and Robinson argue are responsible

¹⁰⁶ Sachs and Warner, "Natural Resource," 6.

¹⁰⁷ Stephan Haggard, *Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries* (Ithaca, NY: Cornell University Press, 1990), 3.

¹⁰⁸ Sérgio Pereira Leite, Anthony Pellechio, Luisa Zanforlin, Girma Begashaw, Stefania Fabrizio, and Joachim Harnack, "Ghana: Economic Development in a Democratic Environment," Occasional Paper 199, *International Monetary Fund*, 2000, <http://www.imf.org/external/pubs/nft/op/199/>

¹⁰⁹ International Monetary Fund, "Ghana—Enhanced Structural Adjustment Facility Economic and Financial Policy Framework Paper, 1998–2000," (n.d.), <http://www.imf.org/external/np/pfp/ghana/ghana0.htm>.

for creating virtuous cycles of development.¹¹⁰ Ghana's move toward inclusiveness is evidenced by its investment in social welfare programs aimed at increasing the skill sets and opportunities amongst its general population. A 2013 study of select Sub-Saharan countries by the IMF showed a strong correlation between increased economic growth and countries that invested in social welfare programs.¹¹¹ The study used public education and healthcare availability as proxy measures to track the level of government commitment toward its citizens, with the authors particularly focusing on opportunities afforded to the poorest in society. The logic behind the methodology being that a state that invests in its most vulnerable citizens is oriented toward inclusive institutions, and inclusive institutions lead to economic growth. The correlation held in the case of post-coup Ghana. In the decades following Ghana's structural adjustment, access to both primary school education and health care increased while the country enjoyed steady economic growth over the same period.¹¹² While the country would remain under the "soft authoritarian" leadership of Mr. Rawlings for several years, the '81 coup was a shift toward political democratization and economic liberalization. Conversely, portions of the international aid to Afghanistan have been used to strengthen patronage networks and shield the leadership in Kabul from the types of international shocks and internal crisis described by Haggard.¹¹³ The current level of international security and financial support provided to Afghanistan has thus lessened the incentives for the nation's leaders to implement reforms aimed at long-term economic growth. This presents obstacles for the realization of resource corridors based on a robust mining industry.

F. THE RENTIER STATE

An unhealthy dependence on resource revenue has similar negative effects on economic growth as an over dependence on foreign aid. While keen government

¹¹⁰ Acemoglu and Robinson, *Why Nations Fail*, 73.

¹¹¹ Olumuyiwa S. Adedeji, Huancheng Du, and Maxwell Opoku-Afari, "Inclusive Growth: An Application of the Social Opportunity Function to Selected African Countries," IMF Working Paper 13-139, *International Monetary Fund*, June 3, 2013, 1.

¹¹² Adedeji, Du, and Opoku-Afari, "Inclusive Growth," 20–26.

¹¹³ Matthew Rosenberg, "Afghan Leader Confirms Cash Deliveries by C.I.A." *New York Times*, April 29, 2013, <http://www.nytimes.com/2013/04/30/world/asia/karzai-acknowledges-cash-deliveries-by-cia.html>.

intervention can steer a state toward diversification in manufacturing and connect its citizens to global markets, other endogenous factors peculiar to resource abundant nations play a significant role in determining whether a country falls prey to the so-called “resource curse.” Resource revenues, much like top down aid programs, affect government institutions in several ways. An emerging generation of scholarship examining the dynamics of the resource curse distinguishes three specific dimensions of the “rentier effect” associated with governments that are effectively dealt a free source of income through resource rents.^{114 115}

First, income streams from resource revenues supplant the need for governments to raise income from taxation. This facilitates a breakdown of the social contract between the state and its residents, as leaders are accountable to a lesser degree when not dependent on public taxation. Second, resource rents run the risk of falling prey to rent-seeking elites in society who funnel the income toward strengthening patronage networks and other unproductive means in the effort to further entrench themselves atop society. Last, resource revenue can spur competition amongst factions in society over the control of the resources. Indeed, empirical evidence suggests that nations endowed with easily extractable and transportable resources such as diamonds tend to suffer from conflict more often than states with resources requiring more effort to process.¹¹⁶

Further research into the resource-conflict correlation from Brunnschweiler and Bulte finds that civil war creates a dependence on primary exports, but the reverse is not true. In a separate piece, Brunnschweiler showed that nations abundant in subsoil resources showed a positive association with economic growth over the period of 1970 – 2000.¹¹⁷ When the study applied measures of institutional quality, using rule of law and government effectiveness as indicators, the data showed a positive correlation between

¹¹⁴ Nazneen H. Barma, “Pathways from Petroleum Dependence to Conflict in Rentier States: A Case Study of Timor-Leste,” 5–6.

¹¹⁵ Ross is credited with the “rentier effect” phrase. Michael L. Ross, “Does Oil Hinder Democracy?” *World Politics* 53, no. 3 (April 2001).

¹¹⁶ Paul Collier and Anke Hoeffler, “Greed and Grievance in Civil War,” Policy Research Working Paper 2355, *The World Bank*, November 1999, 26, doi: 10.1596/1813-9450-2355.

¹¹⁷ Brunnschweiler, “Cursing.”

quality of governance and economic growth. The findings in these two studies confirm what empirical evidence has long suggested—that institutional quality is a primary determinant in whether states suffer from civil conflict, poor economic growth, and other ailments symptomatic of the resource curse.

G. PORTENTS OF RESOURCE REVENUE ON AFGHAN GOVERNMENT INSTITUTIONS

The Mes Aynak copper deposit and the Hajigak iron ore site in Logar and Bamyan provinces represent the two most promising tenders on Afghan soil. A recent quantitative analysis of these two sites places the direct annual impact to national income at U.S.\$ 745 million, or 8.1% of 2008 GNI levels. When procurement of locally sourced inputs are factored in, the figure jumps to U.S.\$ 1.04 billion, or 11.3% of 2008 GNI levels. The average annual exports for the two mines between 2016–40 are estimated to be U.S.\$2.3 billion—a 4-fold increase in export of official goods and services over 2009 figures. The two mines are also expected to directly employ 6,400 personnel with the potential to create several times that figure worth of positions in support and spinoff industries.¹¹⁸ While these figures are admittedly estimates, they are also conservative figures which, even in their lowball state clearly show that the mining sector in Afghanistan has a strong potential to drive sustained economic growth within the country.

The preceding analysis of Afghanistan’s reaction to foreign aid suggests the nation’s governance and institutional quality is ill prepared to handle the potential resource revenue described above. The nature of the Mes Aynak and Hajigak deposits however, provide innate barriers to development, which may bar the government in its current form from exploiting these two sites. Because of the labor and capital-intensive nature of extracting copper and iron ore, both Mes Aynak and Hajigak have been tendered to large state owned enterprises (SOEs) from China and India respectively. Future mining operations will require additional large investments from these two SOEs to build the infrastructure and industrial capacity conspicuously lacking in the region.

¹¹⁸ McMahon and Tracy, “The Afghanistan,” 4.

This is unlikely to happen until governance, rule of law, and stability improves. Interestingly then, Afghanistan may well avoid the misfortunes associated with the resource curse simply because extraction will not happen on a large scale until quality institutions are in place.

H. CONCLUSION

Afghanistan has been subject to the influences of foreign aid since early in its statehood. Much of the aid has been provided by foreign powers more interested in buying allegiance and affecting geostrategic interests rather than building quality institutions and promoting lasting economic growth. The magnitude of current aid programs has overwhelmed Afghanistan's institutional capacity and the nation today remains a highly corrupt and patronage based society. Natural resource revenue, like foreign aid, has the potential to degrade the state-society contract, spur rent-seeking behavior, and incite conflict. These phenomena are more likely to occur in nations with weak institutions and compounded by preexisting conflict. While Large-scale mining in Afghanistan has the potential to become a leading industrial sector, improvements in governance and institutional quality are necessary before resource revenue can become the driver for long-term sustained growth.

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V. AFGHANISTAN’S RESOURCES AND RESPONSIBILITIES

“Men of fat and fertile soil, are most commonly effeminate and cowards; where as contrariwise, a barren country makes men temperate by necessity, and by consequence careful, vigilant, and industrious.”

—Jean Bodin, *Six Books of a Commonwealth*, 1576

A. INTRODUCTION

This chapter provides an overview of the current extractive industry in Afghanistan as well as the potential and feasibility for future development. Specifically, the aim is to describe the resources in terms of quantity, quality, and diversity, and to explain the realities and obstacles to mineral extraction within the country. There are several keys to developing Afghanistan’s natural resource sector. These include establishing support infrastructure, attracting foreign investment, and stabilizing political institutions. The Afghan Ministry of Mines is the primary mechanism for coordinating efforts between various government bureaucracies and the international community; its role is therefore vital to successful development of the nation’s extractive industry. The following section evaluates these important efforts and mechanisms, and highlights important measures undertaken by the MoM and the Government of Afghanistan.

B. IDENTIFIED RESOURCES

Media reports began surfacing mid 2010 after the Pentagon released a memo announcing the discovery of \$1 trillion worth of minerals sunken below Afghan soil. The impetus for the Pentagon press release was the culmination of a joint investigation by the United States Geological Survey (USGS) and the Afghan Geological Survey (AGS) that assessed the mineral potential of much of the region. While this was the first time the West was made privy to Afghanistan’s natural resource potential, the USGS and AGS cannot claim pioneer status in the discovery realm; they merely continued work on decades old Soviet inquests.

Although \$1 trillion is an alluring figure it’s not a fair or accurate assessment of Afghanistan’s resource potential. In a perfect world, where friction and transaction costs

were nil, if Afghanistan were able to bring the entirety of their mineral wealth to market, it may very well fetch them \$1 trillion or more. The reality in Afghanistan is far from perfect however. There are multiple factors that make the \$1 trillion figure a poor measure of the potential mineral value. First, even in a stable and modern country such as the U.S., mining operations never exploit all the target material from a mining site. Extracting every last bit of resource from the ground would be cost prohibitive. This is why ore grade, tonnage, and soil composition are important figures to the mining industry. These statistics determine how easy a given mineral can be extracted from the ground. Depending on the difficulty, a point along the extraction process will be met where it no longer makes economic sense to continue the recovery operation. For some deposits, it doesn't make economical sense to even break ground.¹¹⁹

Seen in this light, it becomes clear that the dollar figure placed on Afghanistan's resources should be viewed skeptically. The good news is that many of the surveyed areas contain high enough grade ore ratios that, all things being equal, they are considered exploitable. Several areas, such as the Mes Aynak copper mine 30 KM south of Kabul, are categorized as "world class" due to their tonnage and material grade reports.¹²⁰ The USGS assesses 12.3 million metric tons (MMT) of copper are recoverable from Mes Aynak alone. Other impressive finds include Haji Gak in Bamiyan province, projected to hold 2 a billion metric tons (BMT) of iron, and mines in Zabul and Western Ghazni that have measured 1,780 kg of readily exploitable gold deposits.¹²¹ All totaled there are currently 22 priority mineral sites in Afghanistan.¹²²

Though the large-scale deposits garner the majority of the attention, the Afghan MoM website currently lists 221 mining contracts, the vast majority of which are small scale private Afghan operations extracting gravel and construction material.¹²³ Beyond

¹¹⁹ Matt Boyd, "IDC Desk Note - Appraisal of Mining Opportunities in Afghanistan," *Information Dominance Center, North Atlantic Treaty Organization*, March 14, 2011.

¹²⁰ John Schroder, "Afghanistan's development and functionality: Renewing a collapsed state," *GeoJournal* 70, no. 2-3, (October 2007): 94, doi:10.1007/s10708-008-9132-1.

¹²¹ *Ibid.*, 96.

¹²² Jeffrey Reeves, "Mining in Afghanistan," *Issues*, no. 99 (June 2012), ProQuest 1022982077.

¹²³ *Ibid.*

the officially recognized sites, Afghanistan is awash with informal and illicit mineral extraction, which feeds a vast smuggling network run by regional strongmen and criminal networks.¹²⁴ Many of these sites have existed for decades and their informal standing is a product of dearth government capacity and 30 years of an evolving war economy, where various factions within the country have exploited natural resources fund their causes.

C. SUPPORT INFRASTRUCTURE

While the quality and quantity of rock is good news, Afghanistan lacks the government competence and support infrastructure to extract and transport this material on a commercial scale. Mines need robust transportation networks and vast sums of water and electricity to operate. Unfortunately for Afghanistan 30 years of continuous war has diminished an already weak industrial base, which has relegated the country to one of the worlds worst in terms of infrastructure. A modern mining sector is almost nonexistent. Historically artisanal mines have been the only show in Afghanistan for good reason.¹²⁵ Currently only 18% of Afghans have electricity - with the bulk of those receiving power being Kabul residents.¹²⁶ Although the U.S. Department of State website now boasts 2,000 km of paved roads in Afghanistan, much of this distance is attributed to the ring road venture that connects major population centers around the country. Major highways capable of supporting heavy tractor-trailers to and from remote mining operations would have to be built from scratch at a high expense. Construction cost varies heavily depending on terrain and road type; the average cost per kilometer in Afghanistan comes in at \$548,000 according to USAID. On the high end, the road to Kabul Airport ran \$1.6 million per kilometer.¹²⁷

A national railway, or lack there of, is another issue. The heavy metals copper and iron ore that comprise the bulk of Afghanistan's mineral wealth require a reliable rail

¹²⁴ Dupee, "Afghanistan's Conflict."

¹²⁵ Reeves, "Mining."

¹²⁶ Office of the Spokesperson, "July 7-9 Tokyo Conference on Afghanistan," Fact Sheet, U.S. Department of State, July 8, 2012, <http://www.state.gov/r/pa/prs/ps/2012/07/194681.htm>.

¹²⁷ USAID/Afghanistan, "Frequently Asked Questions," (n.d.), http://afghanistan.usaid.gov/en/about/frequently_asked_questions.

system to exploit the raw material and deliver it to market. Currently the only rail line that exists in Afghanistan is a 75km stretch between Uzbekistan and Mazar-i-Sharif in the northern reaches of the country. A railway capable of servicing the entire country, including major natural resource areas, would have to cover 3,000 miles of undulating terrain, span gorges, and pierce 16,000-foot mountain ranges. Understandably an undertaking of this sort comes with a massive price tag - \$54 billion according to a report by the U.S. Department of Defense.¹²⁸ To meet these infrastructure needs and raise the large amounts of capital described above requires both time and a buy-in from major companies willing to support the effort. This buy-in unfortunately reduces the profitability across the board for any would be prospectors, while at the same time increasing the bargaining power foreign companies wield during the contracting process. Together these two realities empower outside forces to call the shots on resource extraction feasibility and the timetables for production.

International Interest

Despite the lack of infrastructure there is still plenty of international attention in Afghanistan's mining sector. The swirl of excitement however, must be viewed through a geo-strategic lens since more than profit margins are at play. A closer look at the principle countries involved raises a question of motive. China, India, the United States, and Russia are a few of the nations that are bidding for a piece of Afghan soil. The highest profile contract, the Mes Aynak copper mine went to the Chinese consortium China Metallurgic Group (MCC) in 2007 after it pledged \$3.5 billion to develop the area. Plans included construction of a rail spur, power plant, and relocation of displaced locals.¹²⁹ An Indian consortium, Steel Authority of India limited (SAIL), has snapped up another world-class site, the Haji Gak iron ore deposit in Bamiyan. To enhance its bidding status, SAIL vowed to fund \$10.8 billion worth of projects in Haji Gak including a steel plant, an 800 megawatt power plant, and 200km of rail.¹³⁰

¹²⁸ Dion Nissenbaum, "Doubt Cast on Afghan Mining," *The Wall Street Journal*, October 3, 2012, <http://online.wsj.com/article/SB10000872396390444223104578034742974438144.html>.

¹²⁹ Dion Nissenbaum, "Delays Imperil Mining Riches Afghans Need After Pullout," *The Wall Street Journal*, June 13, 2012, ProQuest 1020040915.

¹³⁰ Ruchira Singh, "India offers low royalty in Afghanistan mining project," *LiveMint*, October 5, 2012, ProQuest 1082359920.

The U.S. foray into the Afghan mining sector is far more modest compared to the state backed ventures of China and India, but is still driven by national security interests and strategic goals. The U.S. initiative, a J.P. Morgan backed gold mine in Qara Zaghan, can trace its birth to Deputy Under Secretary of Defense Paul Brinkley, head of the Taskforce for Business and Stability Operations (TFBSO) team transferred to Afghanistan by the Pentagon. It was evident in 2009 that a vital component to a U.S. exit strategy was a functioning and somewhat self-sufficient Afghan economy. General David Petraeus, U.S. Central Command at the time, prodded Brinkley to apply his lauded development approach in Iraq to the Afghan campaign. Once surrounded by industry experts, Brinkley became convinced that large private Western companies would not jump into the game until small-wildcat operators could show viability.¹³¹ A gold mine venture was chosen specifically because it is a simple enough operation to succeed in spite of Afghanistan's lack of infrastructure.

Gold is relatively easy to retrieve from the soil compared to copper or iron and much more transportable once topside. In all reality, the gold mine is actually a tiny venture for J.P. Morgan—at \$50 million it's almost token.¹³² Despite this, the deal nearly fell apart at the last minute when private investors realized a profitable venture was becoming less likely. It was only through intense Pentagon pressure and additional tax allowances on the Afghan side that the deal was signed. It still remains to be seen whether politics or profit was the central aim of the Qara Zaghan venture, but it is clear that without Department of Defense pressure, purely private companies would have shied away from the adverse risk/reward nature of the current Afghan mining sector.

Government Challenges and Responsibilities

The wide spectrum of extraction operations in Afghanistan, ranging from small-scale artisanal outfits to mega tenders, requires a corresponding range of extraction strategies in order for the country to fully capitalize on its resource wealth. For the larger projects that require foreign capital to get off the ground, the nation must first create a

¹³¹ James Bandler, "J.P. Morgan's hunt for Afghan gold," *CNN Money*, May 11, 2011, <http://management.fortune.cnn.com/2011/05/11/jp-morgan-hunt-afghan-gold/>.

¹³² Nissenbaum, "Delays."

favorable investment environment. According to Tamin Asey, an economist and prior director of the Afghan MoM, “When you go to a conference, the No. 1 question is not security for investors, it’s the political and legal stability of the country.”¹³³ Indeed, investors need a level of assurance that the political regime they are dealing with will remain in power, and that contracts and state legislation are not subject to abrupt alteration. Political stability remains a prime yet monumental task for Afghan leaders. 2014 hosts presidential elections, a foreign military drawdown, and more political uncertainty for Afghanistan, a key reason future investment in the mineral sector is static and current investors are biding their time before sinking additional funds in the country.¹³⁴

On the other end of the spectrum, the numerous small-scale and illicit mining operations present a separate, yet equally challenging problem for the Afghan government. The informal extraction network exists due to lack of government capacity to enforce rules and regulations on the extraction and transport of easily acquired minerals. The existence of a parallel mining economy presents several barriers to progress in Afghanistan. First, illicit extraction of chromite and semiprecious gemstones have provided funds to insurgents and non-state actors with disparate political and ideological goals.¹³⁵ Second, much of the illicit material is smuggled out of the country thus denying the state valuable tax revenue. Lastly, the primitive nature of informal extraction is inherently inefficient—crude techniques often damage and destroy material, thereby stripping the state of its full resource potential.

A set of incentives and deterrence measures are needed in order for the Afghan government to formalize the illicit and unofficial mining sector. In his piece, “Does Lootable Wealth Breed Disorder? A Political Economy of Extraction Framework,” Brown University Political Scientist Richard Snyder advances the concept of a “joint

¹³³ Sean Carberry, “Afghan Mineral Treasures Stay Buried, Hostages to Uncertainty,” *Parallels*, *National Public Radio* audio 3:25, May 18, 2013, <http://www.npr.org/blogs/parallels/2013/05/18/184775139/Afghan-Mineral-Treasures-Stay-Buried-Hostage-To-Uncertainty>.

¹³⁴ Waslat Hasrat-Nazimi, “Afghan mining deal with China facing failure,” *Deutsche Welle*, July 31, 2013, <http://www.dw.de/afghan-mining-deal-with-china-facing-failure/a-16989797>.

¹³⁵ DuPee, “Afghanistan’s Conflict.”

extraction” (public-private) process as a viable method for bringing illicit activities into the legal fold.¹³⁶ The idea is for the government to employ a series of carrot-and-stick measures such as tax breaks, pay in lieu of harassment, protection from competitors, new licit investment opportunities, etc. The key to forging a relationship of joint extraction however, is the ability of the government to block the activity in its illicit form. When the state is able to do this, the illicit actor’s calculus is reduced to either joint extraction, or no extraction.

D. MINISTRY OF MINES/ANTI GRAFT MEASURES

The Afghan MoM has a crucial role in courting international investors. According to Wahidullah Shahrani, MoM head, “The Ministry of Mines can no longer be the owner and operator of mines.”¹³⁷ In this sense, the MoM has taken a privatization-liberalization approach to the development of Afghanistan’s mining sector—relying on private companies to provide their own business plans and infrastructure. The ministry has also pledged to transfer existing Afghan state run enterprises to the commercial sector. Their modus operandi thus far has been to open bids to private enterprises for recognized sites, secure contracts for predetermined royalties, and impose flat corporate tax rates.

Soon after the Mes Aynak deal was struck in 2007, the former MoM director was exposed by U.S. officials for accepting a \$30 million dollar bribe from MCC executives—bad press for an organization desperate for Western investment. As of late however, the MoM seems well aware of its tainted image and has since made commendable strides to repair damage and move away from systemic corruption of the past. The Minister in question was removed and replaced by the current Minister, Mr. Shahrani. In a recent appearance during the opening session of an Afghan / Tajik basin tender project, Shahrani uttered the word “transparency” four times in a short three paragraph statement, obviously aware of his international audience. In 2010 Afghanistan

¹³⁶ Richard Snyder, “Does Lootable Wealth Breed Disorder? A Political Economy of Extraction Framework,” *Comparative Political Studies* 39, no. 8, (2006): 943-968, doi:<http://dx.doi.org/10.1177/0010414006288724>.

¹³⁷ Ministry of Mines and Petroleum, Islamic Republic of Afghanistan, “Ministry of Mines,” (n.d.), <http://www.mom.gov.af/>.

became an Extractive Industries Transparency Initiative (EITI) candidate country. EITI promotes global standards through independent robust oversight of government revenue accounting.¹³⁸ Finally, to aid in securing international funding at the July 2012 donor's conference in Tokyo, the MoM published more than 220 mining contracts, which are available for public consumption directly from their website.

Despite these efforts the MoM still fights an uphill battle against corruption and Afghan style crony capitalism. The ministry unfortunately does not operate in a vacuum but rather is subject to the approval of the Afghan Parliament for vital mining legislation. A recent change initiated by the MoM to the current mining legislation—a provision that would grant sole exploitation rights to the discovering party—remains stalled in bureaucracy. The provision is seen as key to attracting additional foreign investors; its hang-up, however, is that infighting is feared between government officials over the spoils of the country's natural resource treasure.¹³⁹ Lastly there is the issue of favoritism. While the MoM may have elevated itself above shameless bribery, the patronage system still runs deep. India has become a preferred country according to industry officials.¹⁴⁰ This can be seen in proposals recently submitted by SAIL offering an extremely low 1% royalty compared to 4% offered by others. Despite this lowball figure India is considered the frontrunner for geo-political reasons.¹⁴¹ The Indians and Afghans view this preferred relationship as a win-win setup. The Indian government has pledged \$2 billion in aid for Afghan infrastructure; in turn they get a bigger footprint in the region and discounted access to greatly needed raw materials.

E. POSITIVE INITIATIVES

Beyond the adoption of EITI standards and the publishing of mining contracts, the MoM has additionally taken broader initiatives to leverage the budding extractive industry toward greater diversification and sustained growth. Chief among these are the

¹³⁸ Ibid.

¹³⁹ Graham Bowley, "Potential Boon in Afghan Mining Stokes Rivalries," September 9, 2012, ProQuest 1038481479.

¹⁴⁰ Singh, "India offers."

¹⁴¹ Ibid.

Afghan National and Regional Resource Corridor Program (NRRCP), and the Skills Strategy development initiative (SSD), a subprogram of the NRRCP.

The NRRCP is joint venture undertaken between the Government of Afghanistan and the World Bank, with the latter providing funding and oversight. The Afghan Ministry of Finance is responsible for funding the program through World Bank loans, while the Ministry of Public works, and MoM are responsible for project implementation. The idea behind the project is to levy “A sequence of investments and actions to leverage a large extractive industry investment in infrastructure, goods and services, into viable economic development and diversification along a specific geographic area.”¹⁴² The NRRCP has been designated a National Priority Program (NPP) by the Afghan government.

Key to the success of the NRRCP is ensuring Afghan citizens are prepared for the job opportunities available as the extractive industry develops. The SSD program, in its initial stages, is charged with identifying potential demands of the mining sector, and devising mechanisms to match future requirements with organic labor and supplies. The project’s initial recommendations will inform government officials on where best to invest donor money in the skills development sector.¹⁴³ If successful, the SSD has the potential to increase both Afghanistan’s total factor productivity and the capability to extract added value from the mining sector.

F. CONCLUSION

Afghanistan is a resource rich country possessing a diverse array of minerals and hydrocarbons. The country’s extreme landscape and societal unrest however, pose significant obstacles to development of the nation’s resource sector. A stable government, which is able to coordinate across multiple bureaucratic ministries, is key to attracting the

¹⁴² The World Bank, “Project Information Document (PID) Concept Stage,” April 23, 2013, http://www-wds.worldbank.org/external/default/WDSP/SAR/2013/04/23/090224b081af8994/1_0/Rendered/PDF/Project0Inform0or0Project000P145443.pdf.

¹⁴³ Australian AID, “Afghanistan Resource Corridor Skills Strategy Development Final Report, Executive Summary,” November 25, 2012, http://www-wds.worldbank.org/external/default/WDSP/IB/2013/07/24/000442464_20130724122459/Rendered/PDF/797240BRI0P1280Box0379789B00PUBLIC0.pdf.

foreign investment and donor aid imperative for development of major mining operations. Stability in Kabul is also vital to reestablish authority over small-scale, illicit outfits. The MoM has made significant strides in promoting transparency and implementing international standards and best practices, yet the ministry remains a shining example in an otherwise tumultuous administration.

VI. UNLOCKING AFGHANISTAN'S RESOURCE POTENTIAL

“Little else is required to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice, all the rest brought about by the natural course of things.”

—Adam Smith, economist, 1775

A. POSITIVE EMPIRICAL INDICATIONS

The potential for medium and large-scale mining operations within Afghanistan has had a positive effect on institutions charged with opening the industry to local and international firms. Since 2010 the Afghan Ministry of Mines has revised the country's mining regulations toward international industry standards, joined the EITI, published its mining contracts, and dismissed its corrupt former leadership. These positive measures, which are a product of the realization that unlocking the potential of Afghanistan's resource abundance requires foreign investment, have had emanated outwards from the Ministry of Mines and produced similar results in agencies and institutions adjacent to the emerging mining sector.

Also established in 2010, the Ministry of Finance's National Priority Program, a wholly independent Afghan initiative, indicates a significant move toward a future-oriented development strategy. Elements crucial to the development of Afghanistan's natural resource sector—skills development, EITI, and the National and Regional Resource Corridor programs—are all prominently featured in the Ministry of Finance's National Priority initiative.¹⁴⁴ Equally important to note is that the initiative was personally introduced by Hamid Karzai, an encouraging sign that leadership in Kabul is aware of the importance of inclusive institutions on long-term growth and development.

B. BINDING CONSTRAINTS

The most difficult obstacle to the success of Afghanistan's resource extraction sector lies in the political instability of the country. Despite glimmers of optimism,

¹⁴⁴ Ministry of Finance, Islamic Republic of Afghanistan, “National Priority Programs - Ministry of Finance,” (n.d.), <http://mof.gov.af/en/page/3976>.

Afghanistan's social welfare commitments are in their infancy, and the country remains politically unstable. The traditionally decentralized form of rule practiced in Afghanistan has been most successful when healthy relationships existed between rulers in Kabul and powerful elites in the surrounding regions. Decades of civil war and foreign intervention however, has severed long standing patronage networks and has upset key center-peripheral relationships, which has ultimately diminished Kabul's influence in rural Afghanistan. The central government's lack of influence and legitimacy poses a challenge to the implementation of social and economic reforms necessary to convert the country's resource wealth into long-term growth and development.

A survey of the foreign development aid expended in Afghanistan in the past 12 years shows that the sheer volume of disbursements created a condition where rent-seeking often took precedence over productive investment. Put simply, large amounts of cash and unstable institutions incentivized many to use funds in unproductive ways rather than invest in an uncertain future. While development aid did result in gains in infrastructure, many of the projects such as the country's ring road came with an enormous price tag as construction was sub-contracted on multiple levels, with each firm collecting fees in return for little productivity.

This thesis paid particular attention to the application of aid flows in Afghanistan to approximate the country's susceptibility to the resource curse as the nation's mining sector fully emerges. In certain instances aid, and similarly resource revenue, can amount to windfall gains, where rents result in dependence and perverse economic incentives. While this study found that fiscal and monetary policies were inadequate to handle the large amounts of aid in Afghanistan, it also found that there is a critical difference between the aid flows in the country and the potential revenue arising from large-scale resource extraction. The nature of the resource deposits in Afghanistan make necessary investments in both time and infrastructure before large-scale extraction can occur. In this sense, resource rents will not have the characteristic of a windfall gain, but rather slow and steady revenue. This dynamic lessens the likelihood of Afghanistan falling prey to the resource curse.

C. QUALITATIVE RESULTS

This case study comes at crucial point in the Afghan Government's pursuit of economic self-sustainability. The nation's parliament is currently deciding the future of vital mining legislation, the passage of which opens the gate to considerable foreign investment. Approval of the bill will signal broad government commitment to long-term economic development. As this study has shown, since 2010 policy makers have taken all the right steps to ensure the country's resources will be extracted according to international standards and best practices. There is every reason to believe that this trend will continue.

The aim of this thesis was to narrowly focus on the effects of resource abundance on government institutions. Exogenous shocks, such as adverse foreign intervention and third party spoilers, while in the realm of possibility, were not factored in the analysis of Afghanistan's most likely mineral sector trajectory. Three possible hypotheses were presented in the first chapter of this study. Considering the evidence presented, it is clear that the Afghan Government has realized its resource potential and has put in place the mechanisms to capitalize both on the minerals themselves, and on economic linkages associated with the resource sector. Based on this analysis, the most likely hypothesis is one in which the resource extractive industry continues to positively affect government institutions and drives economic growth in the long term.

D. POLICY IMPLICATIONS

There are several policy implications for Afghanistan going forward as a result of the interplay between natural resources, governance, economic growth, and conflict described in this study. The government of Afghanistan and the Ministry of Mines must continue to adhere to international standards and best practices in awarding resource tenders and structuring contracts for large-scale mining operations. The country must also continue to prepare its citizens to take advantage of the business opportunities that will become available with the induction of large-scale extraction, processing, and transporting of resources. On the international level, transparent business practices must be the standard. For certain medium and smaller scale domestic projects however, a given

level of patronage may be initially necessary to stabilize relations between Kabul and operations in peripheral areas of the nation. To stem the illicit small-scale extraction and smuggling networks in the country, the government needs to offer incentives for cooperation such as immunity, low initial royalty rates, and property ownership in order to bring the informal economy into the legal fold.

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